



Monday, 04 November 2019



Analysts:

Renaldo D'Souza

+254 (20) 2222651

Renaldo.DSouza@sterlingib.com

Susan Makena

+254 (20) 2222651

Susan.Makena@sterlingib.com

Elizabeth Njenga

+254 (20) 2222651

Elizabeth.Njenga@sterlingib.com

Justina Vuku

+254 (20) 2222651

Justina.Vuku@sterlingib.com

Safaricom Plc

HY2019/20 Earnings Update

“Hits and misses”

For queries call: +254 (20) 31 5414; 2244077 or

Email: research@sterlingib.com

Website: www.sterlingib.com

Bloomberg Code: SCLK <GO>

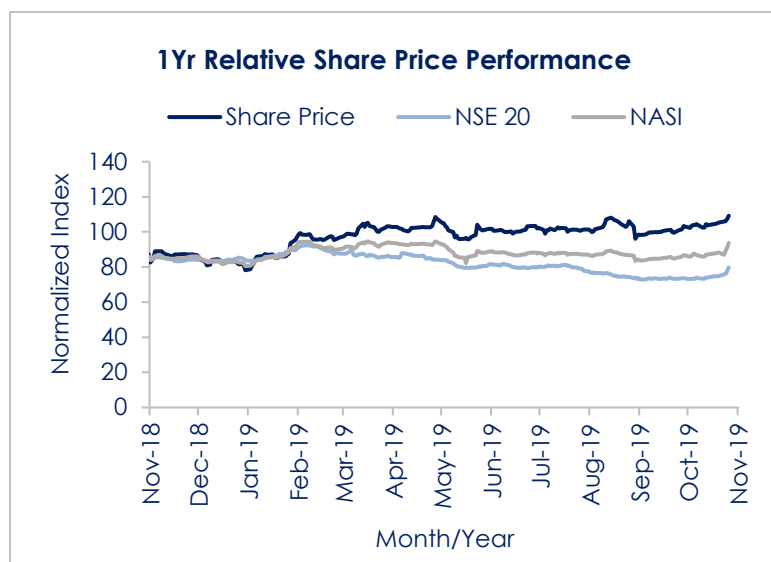
Table of Contents

Executive Summary.....	3
Overall Financial Performance.....	5
A) Service Revenue Analysis & Outlook.....	5
B) Operating Costs & Capital expenditure.....	6
Conclusion.....	7
Disclosures:.....	8

For important disclosures refer to the disclosures section located at the end of this report.

Executive Summary

- Safaricom Plc (Safaricom) released its HY/20 financial results on 1st November recording a 14.4% increase in net profit to KES.35.7Bn.
- Growth in profitability was largely supported by strong performance of fixed data (+18.4%) and M-Pesa (+18.2%).
- Mobile data remains a key revenue driver for Safaricom. However, stiff price competition has declining growth rate (+4.4%) compared to the same period the previous year.
- We draw attention to voice calls and messaging revenues that declined 1.4% and 11% respectively during the period in review due to changes in technology and price competition.
- Subscriber growth was strong during the period with 8.9% increase in new subscribers, 14.8% and 12.4% growth in 30 day active mobile data and M-Pesa subscribers respectively.
- Fuliza remains integral to the growth and retention of subscribers contributing KES.1.3Bn in revenue for the period.
- The company recorded a marginal decline in operating expenditure suggesting that cost management measures are in place to maintain bottom-line growth.
- We expect the company to focus on key service revenue lines such as mobile data and voice calls where it continues to face aggressive price competition.
- Fixed data has emerged as a high growth potential segment with the company expected to take over market leadership and investments in fixed network expansion should be expected.
- Our forecasts for the FY20 are Net profit growth of 12% to KES.70Bn.
- We revise our recommendation from BUY to HOLD with a fair value estimate of KES.31.31 representing a 3.3% from the trading price of KES.30.30 (1st November 2019).

Fig 1: Share price performance & share data statistics


Source: Nairobi Securities Exchange

Share Data

NSE Code	SCOM
Bloomberg Code	SAFCOM:KN
Share Price (KES)	30.3 (1-Nov-19)
Fair value estimate (KES)	31.31
Upside/ (Downside) (%)	↑ 3.3
Recommendation	HOLD
Market Cap (KES.Bn)	1,214
Free Float (%)	25
Price Change YOY (%)	↑ 28.9
Price Change YTD (%)	↑ 36.5
52 Week High/Low	KES.32.50 -21.00
P/E	19.2
P/B	10.4
Dividend Yield (%)	4.1

Source: Source: Nairobi Securities Exchange & Sterling Capital Research

Fig 2: Financial Performance Summary

Metrics	HY2018/19	HY2019/20	YoY Growth	FY2018/19	FY2019/20E	YoY Growth
Voice Calls	47.5	46.9	1.4	95.8	93.8	2.1
SMS	9.7	8.6	11.0	19.6	16.4	16.3
M-Pesa	35.5	42.0	18.2	75.0	84.1	12.1
Mobile Data	19.0	19.8	4.0	36.3	38.8	6.9
Fixed Data	3.8	4.6	18.4	8.1	10.1	24.7
Total Service Revenue	122.7	124.3	5.3	239.8	250.5	4.5
Total Direct Costs	35.0	37.5	7.1	71.8	75.8	5.6
Gross Profit	87.7	92.1	5.0	177.9	185.2	4.1
Total Operating Expenses	25.8	25.6	0.8	53.6	54.8	2.2
EBITDA	61.8	66.5	7.6	124.3	130.4	4.9
EBITDA Margin (%)	50.4	51.3	0.9	49.8	49.9	0.2
EBIT	44.2	49.8	12.7	89.0	97.8	9.9
EBIT Margin (%)	36.1	38.5	2.4	35.6	37.4	5.1
Net Income	31.2	35.7	14.4	62.5	70.0	12.0
EPS	0.78	0.89	14.1	1.58	1.75	12.2

Source: Safaricom Plc & Sterling Capital Research

For important disclosures refer to the disclosures section located at the end of this report.

Overall Financial Performance

- Service revenue growth 5.3% to KES.124.3Bn supported by strong growth in Fixed data (+18.4), M-Pesa (+18.2%) and Mobile data (+4%).
- Net profit KES.35.7Bn representing a 14.4% growth over HY19.
- Operating costs declined 0.9% over the previous year.
- Slowdown in the gaming (betting) industry had a negative impact on M-Pesa growth which declined albeit positive.

A) Service Revenue Analysis & Outlook

1) Voice Calls Revenue

- Recorded a 1.4% decline over the previous year to KES.46.9Bn. The decline is mainly attributed to price competition and increased adoption of Over the Top (OTT) services like WhatsApp, Facebook etc.
- Voice calls HY20 accounted for 34.7% of total service revenue compared to 37.3% HY19.
- We expect Safaricom to attempt to drive voice calls revenue through price offer promotions to drive subscriber numbers and protect market share.
- Nevertheless we forecast voice call revenue FY20 estimate at KES.93.8Bn a 2.1% decline over the previous year.

2) Messaging

- Like voice calls, messaging revenue exhibited a decline largely because of changes in technology (OTT services) and price competition.
- Messaging revenue declined 11% over HY19 to KES.8.6Bn.
- Reversing this trend would be a stiff challenge not only to Safaricom but also other players in the sector as aggregate industry voice traffic is expected to decline over time.
- However, we are likely to see gains in mobile data usage and therefore revenues due to the substitution effect where growth of data enabled messaging services drives data demand.
- Our FY20 projected messaging revenue is KES.16.4Bn a 16.3% decline over FY19.

3) M-Pesa

- M-Pesa revenues grew 18.2% to KES.41.97Bn in HY/20 driven by 12.4% increase in 30-day active M-Pesa customers to 23.6Mn.
- The growth was also due to a 7.8% growth in monthly usage per customer to 13 chargeable transactions per month.
- M-Pesa now accounts for 33.8% of service revenue and we expect this to increase to 37.7% by FY/21.
- Fuliza has a positive impact on M-Pesa revenue contributing KES.1.3Bn in HY20 while gaming revenues declined by 15.5% from a growth of 7.6% in HY/19.
- We are impressed that in spite of the exit of betting companies from operation M-Pesa recorded 20.9% revenue growth higher than 19.1% HY/19.
- We forecast 12.1% growth in M-Pesa revenues FY20 to KES.84.1Bn.

4) Mobile Data

- Mobile data recorded KES.19.8Bn in revenue HY/20, a growth of 4% over the same period in the previous year.
- Average data usage increased 43.6% due to a reduction in mobile data tariffs to ward of competitive threats.
- Stiff price competition is expected from other operators in this service line. We however do not expect counter competition engagement by Safaricom with most efforts limited to growth in usage through marketing and value added promotions.
- Data customers using more than 100MBs increased by 39.3% to 7.9Mn customers from 6 Million customers HY/19.
- Removal of the expiry date on data will have a positive impact on mobile data subscribers which in turn will drive revenues. The impact of this move however might not be significant in H2 2020.
- Our projected mobile data revenue FY/20 is KES.38.8Bn a 6.9% growth over the previous year.

5) Fixed Data

- Fixed data maintained double digit revenue growth HY/20 at 18.4% to KES.4.6Bn contributing 3.7% to service revenue (HY/19 - 3.3%).
- The number of homes connected to Fiber to the Home (FTTH) increased by 44.5% compared to HY/19, contributing 11.1% to fixed data revenue growth.
- Fiber to the Business (FTTB) recorded 15.9% increase in the number of fixed data links from 18.6 thousand links HY/19 to 21.6 thousand links HY/20.
- According to the Communication Authority of Kenya (CAK), Safaricom's market share in fixed data increased to 32.7% to stand at 137,824 subscribers in the quarter to June 2019 compared to 21.2% in the same period in 2018.
- We anticipate Safaricom to close FY/20 as the market leader in fixed data driving revenues up to KES.10.1Bn

B) Operating Costs & Capital expenditure

Capital Expenditure (Capex)

- Capital expenditure (Capex) rose to KES.18.1Bn compared to KES.17Bn the previous year with close to 40% of expenditure directed towards improvement of radio access spectrum.
- As testimony of the potential growth of the fixed data business, 9.1% of total capex in HY2020 was directed towards the fixed data network.
- Capex intensity (ratio of the total capex to sales revenue) has declined to 14% (FY2019 – 14.9%) showing the positive impact of investments on revenue growth.
- Our capex estimate FY/20 are KES36.8Bn.

Direct & Operating Costs

- Direct costs declined 7.2% to KES37.5Bn while operating costs declined 0.9% to KES25.6Bn.
- The management of operating costs is positive in our view especially with the existence of competitive threats that continue to strain price margins.
- However, this is unsustainable in the long run and the bottom-line will remain highly dependent on the ability of the company to grow its revenues.
- We estimate a 2.3% growth in operating costs FY/20 to KES.54.8Bn.

For important disclosures refer to the disclosures section located at the end of this report.

Conclusion

- HY2019/20 financial results were fairly good and within our expectations in consideration of the stiff operating, regulatory and competitive environment.
- Declining voice calls and messaging revenue will continue with both voice and messaging traffic expected to continue declining.
- Focus will be on driving both M-Pesa, mobile and fixed data where Safaricom has strong market positioning.
- Growth in these service lines together with operating costs management will help offset declining voice and messaging revenue.
- Nevertheless, we expect positive growth (12%) in Net Profit FY/20 to KES.70Bn with the performance translating to an improved dividend (approximately KES.1.75) based on the customary 80% dividend payout ratio.

Disclosures:

Ownership and material conflicts of interest:

The authors or a member of their household, of this report do not hold a financial interest in the securities of this company. The authors or a member of their household, of this report do not know of the existence of any conflicts of interest that might bias the content or publication of this report.

Position as an officer or director: The authors or a member of their household, do not serve as an officer, director or advisory board member of the subject company.

Research analyst certification:

The research analyst(s) primarily responsible for the preparation and content of all or any identified portion of this research report hereby certifies that all of the views expressed herein accurately reflect their personal views. Each research analyst(s) also certify that no part of their compensation was, is, or will be, directly or indirectly, related to the view(s) expressed by that research analyst in this research report.

Additional Disclosures:

This research report is for distribution only under such circumstances as may be permitted by applicable law. This research report has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient, even if sent only to a single recipient. This research report is not guaranteed to be a complete statement or summary of any securities, markets, reports or developments referred to in this research report. Neither SCL nor any of its directors, officers, employees or agents shall have any liability, however arising, for any error, inaccuracy or incompleteness of fact or opinion in this research report or lack of care in this research reports preparation or publication, or any losses or damages which may arise from the use of this research report.

Disclaimer:

This research report was prepared under the supervision of the Research Department of Sterling Capital Limited (SCL), a company authorized to engage in securities activities in Kenya, and with partnerships in Uganda, Rwanda, Zimbabwe, and Tanzania. Data used in this report was gathered from reliable sources, but the analyst(s) and the publishers of this report do not hold themselves responsible for the accuracy or completeness of data used. The report provides the opinions, analyses and conclusions of the Research division only and is provided without any warranties of any kind.

This report does not constitute an offer, or the solicitation of an offer, for the sale or purchase of any security. The reader should independently evaluate the investment risks and is solely responsible for their investment decisions. Whilst every care has been taken in preparing this report, no representation, warranty or undertaking (express or implied) is given and no responsibility or liability is accepted by SCL or any employee of SCL as to the accuracy, timeliness, completeness merchantability or fitness for any particular purpose of any such recommendation or information contained and opinions expressed herein. SCL do not accept any liability for any direct or remote loss or damage arising out of the use of all or any part of the information contained in this report.

This report is published for information purposes only and is not an offer to solicit, buy or sell any security of any kind. This report does not provide customized investment advice. It has been prepared without regard to the individual financial circumstances and risk and return objectives of individuals who receive it. The appropriateness of a particular investment will depend on an investor's individual circumstances, risk tolerance and return objectives. The investments securities referred to in this document may not be suitable for all or certain categories of investors. The Research Division and SCL have implemented Chinese walls procedures to prevent any conflict of interest. Other additional information may be available at SCL.

Further disclosure regarding SCL policy on potential conflicts of interest in the context of investment research and SCL policy on disclosure and conflicts in general are available on request. The opinions presented in this note may be changed without prior notice or cannot be depended upon if used in the place of the investor's independent judgment. The historical performance of a security is not representative of the security's future returns. Investment in securities can be highly risky as security prices may go down in value as well as up and you may not get back the full amount invested. Where an investment is denominated in a currency other than the local currency of the recipient of the research report, changes in the exchange rates may adversely affect the value, price or income of that investment. In case of illiquid investments for which there is no organized market it may be difficult for investors to exit investment positions or to obtain reliable information about its value or the extent of the risk to which it is exposed. The information contained in this report is confidential and is solely for use to those persons to whom it is addressed and may not be reproduced, further distributed to any other person or published, in whole or in part, for any purpose.