



Capital

Wealth **Management**

Safaricom Plc

HY22 Earnings Expectations Note

Tuesday, November 9, 2021

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Safaricom Plc

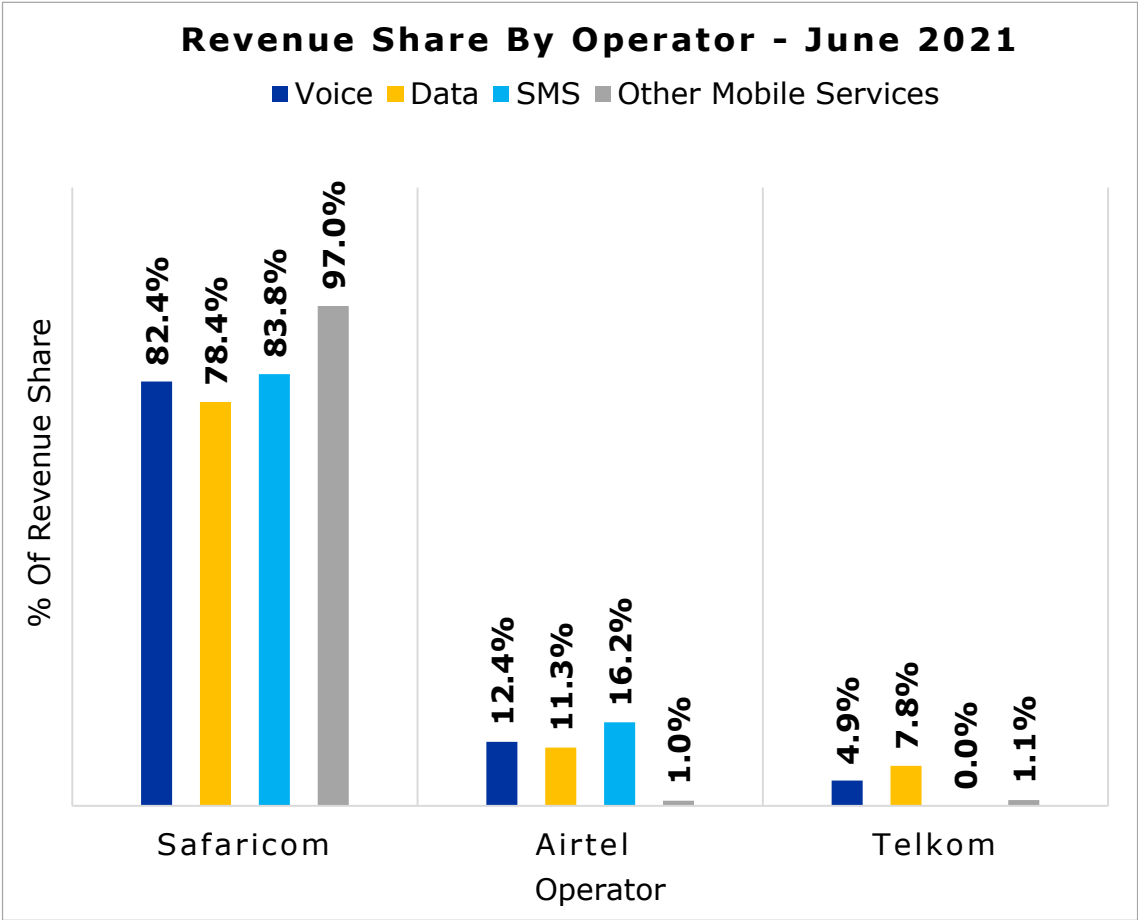
- Safaricom is set to release its HY22 financial results this month. We issue a **HOLD** recommendation on SCOM based on a fair value estimate of **KES.39.46**, a 1.5% downside from the current market price of KES.40.05. As the economic recovery continues, we expect strong earnings growth in M-Pesa and data to drive the telco's revenues FY22.
- We project M-Pesa to be the biggest service revenue contributor FY22 mainly boosted by the reinstatement of mobile money transaction fees, growing use of mobile money payments, international money transfer and increased mobile lending via Fuliza, M-Shwari and KCB M-Pesa.
- Mobile data consumption continues to be boosted by increased 4G penetration, Safaricom's smart phone drive, tech savvy youthful population and the telco's drive of data affordability by encouraging bundle usage through price reduction.
- Safaricom is now the market leader in the fixed data space having significantly grown its market share through network infrastructure expansion, aggressive marketing, improved customer experience and network reliability. Growth in connections due to work from home and new emerging business opportunities will further drive fixed data revenues going forward.
- Voice calls and SMS revenues are expected to decline further mostly driven by competition from other service providers (Airtel and Telkom) and migration of customers to newer technologies (over the top services) such as WhatsApp, Skype and Telegram.
- We project HY22 total service revenue to come in at KES.136Bn (+14.9%) and a 33.3% growth in PBT to KES.59.7Bn.

SCOM Data

NSE Code	SCOM
Bloomberg Code	SCOM:KN
Current Price	40.05 (8 th Nov, 2021)
Target Price	39.46
Upside/ (Downside) (%)	↓1.5%
Recommendation	HOLD
Market Cap (KES. Bn)	1,604.6
Price Change YTD (%)	↑16.9
52 Week High/Low	KES. 45.25 -37.80
P/E	23.4
P/B	11.7
Dividend Yield (%)	3.4

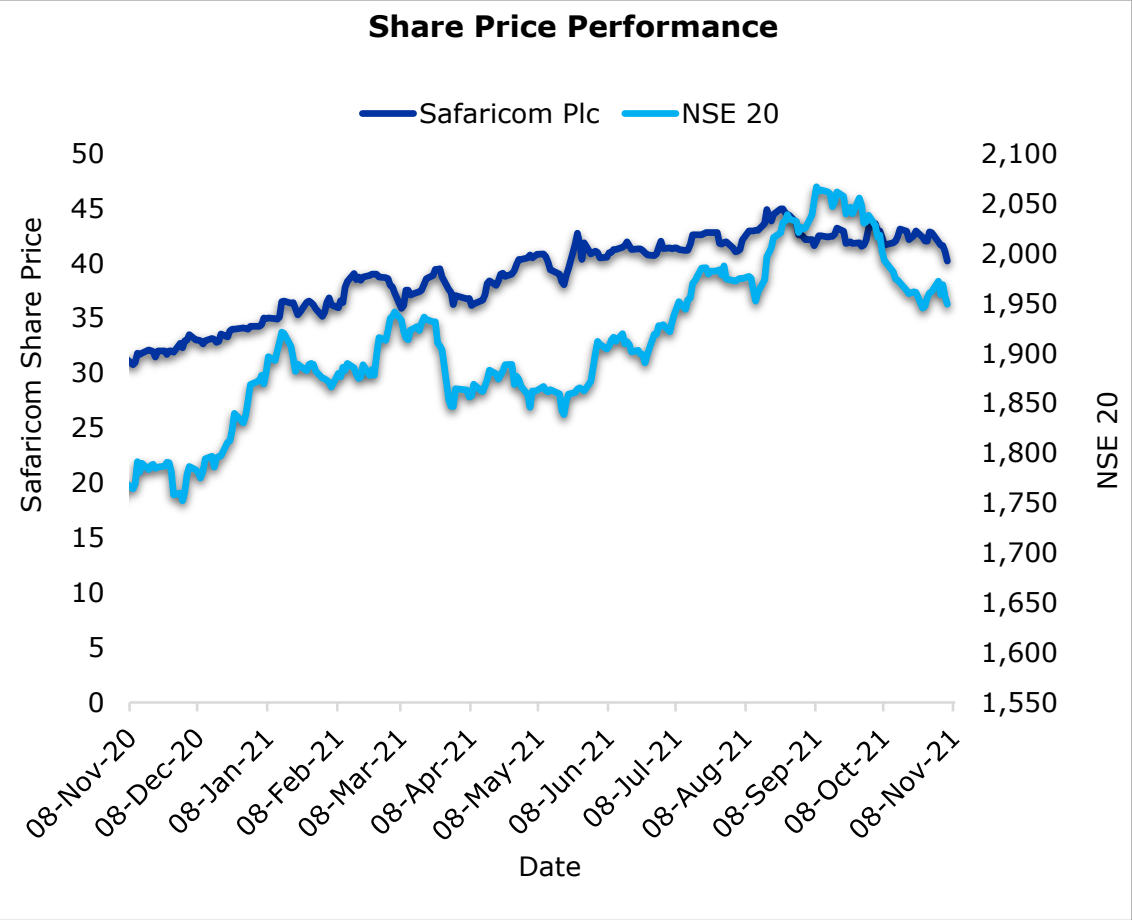
Revenue Share by Operator & Share Price Performance

Chart.1: SCOM enjoys a significant share of the industry revenues



Source: Communications Authority

Chart.2: Share price has outperformed the NSE 20



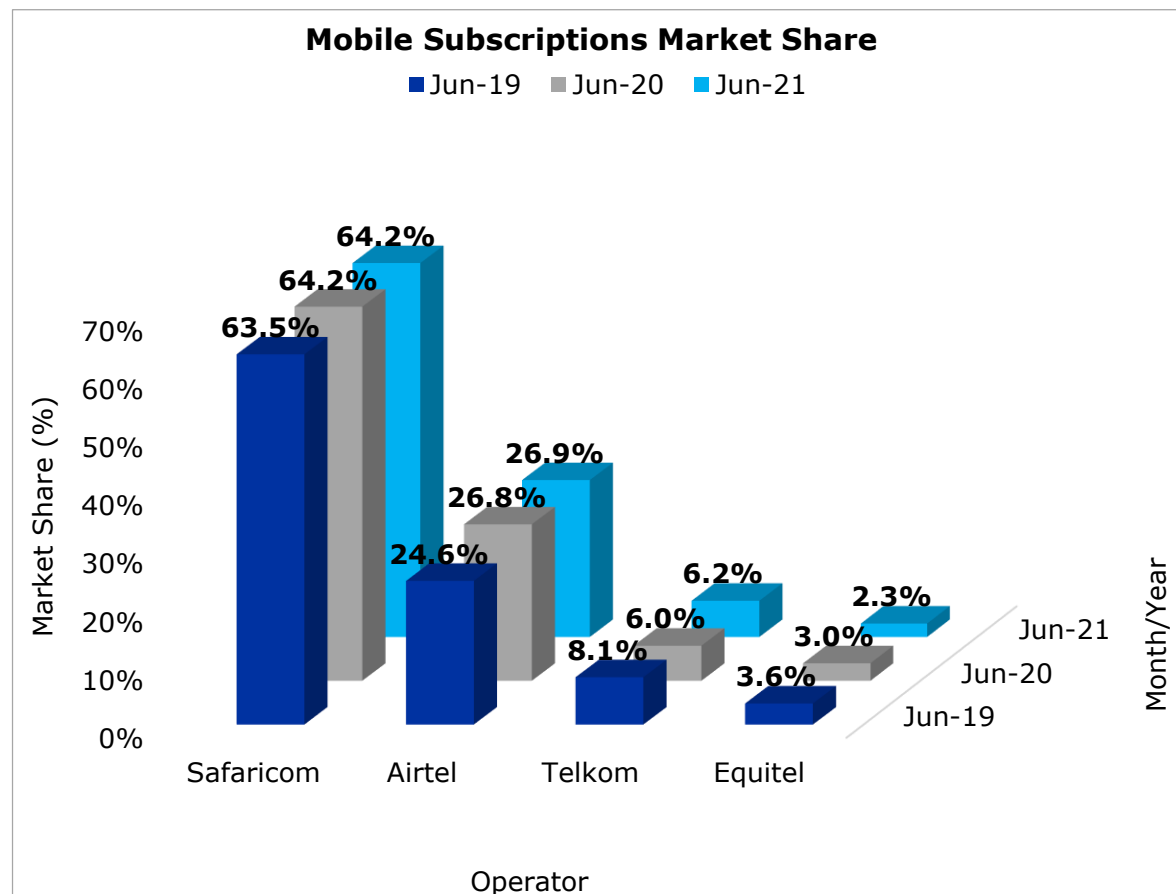
Source: Nairobi Securities Exchange

Half Year Financial Summary

	HY21 (KES.Bn)	HY22E (KES.Bn)	% Change YoY
Voice Calls Revenue	40.2	39.8	0.9%
SMS Revenue	7.2	6.0	16.5%
Mobile Data Revenue	22.2	23.7	6.7%
M-Pesa Revenue	35.9	52.1	45.1%
Mobile Incoming Revenue	4.6	5.2	13.1%
Fixed Data Revenue	4.5	5.2	15.0%
Other Service Revenue	3.8	4.0	5.0%
Total Service Revenue	118.4	136.0	14.9%
Total Revenue	124.5	143.5	15.2%
Total Direct Costs	(37.0)	(41.3)	11.4%
Gross Profit	84.6	101.7	20.3%
Total Operating Expenses	(21.2)	(22.9)	7.9%
Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA)	63.4	78.8	24.4%
Earning before Interest and Tax (EBIT)	45.0	60.9	35.3%
Profit Before Tax	44.7	59.7	33.3%
Profit After Tax	33.1	41.8	26.3%

Mobile Subscriptions Market Share

Chart.3: SCOM subscriber market share at 64.2%

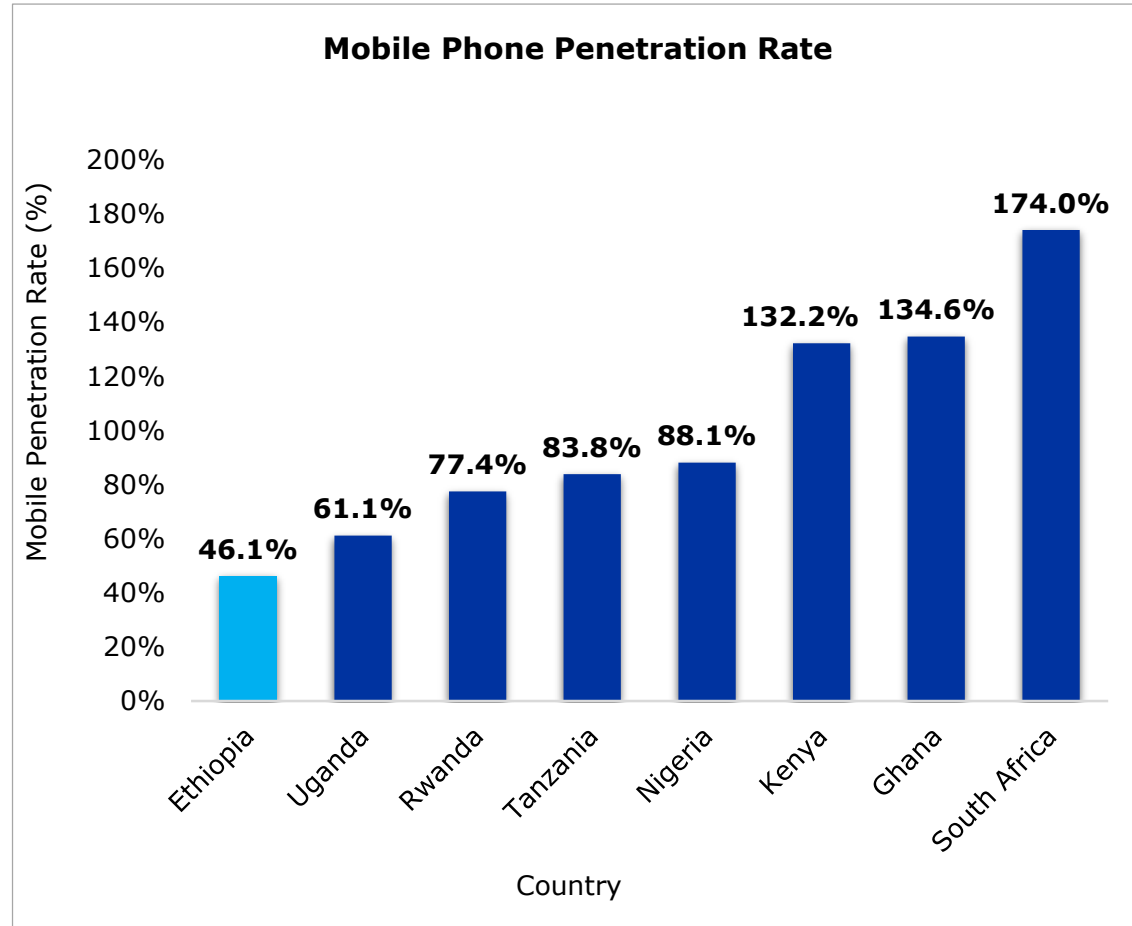


Source: Communications Authority

- Safaricom remains the market leader in total mobile subscriptions.
- Latest data from Communications Authority (CA) (Q4 2020/21, March – June 2021) shows Safaricom's share of total mobile subscriptions grew to 64.2% (41.4Mn) from 63.5% (33.1Mn) in June 2019 (Chart.3).
- During the period Airtel's market share went up from 24.6% to 26.9% while for Telkom declined to 6.2% from 8.1%.
- In the period March-June 2021, the telco's subscribers grew by 3.7% from 39.9Mn to 41.4Mn with the growth attributable to a promotion dubbed '*Welcome to Safaricom 4G*' which ran from 12th March to 9th June 2021.
- The telco targeted consumers to subscribe to their network for the first time by purchasing a 4G SIM card and 4G phone with the benefit of 2GB data bundles every month during the promotion period.
- The period also coincided with closure of primary and secondary schools that contributed to re-activation of SIM cards by school going children ~ CA.

Ethiopia Opportunity

Chart.4: Growth potential with Ethiopia penetration rate at 46.1%

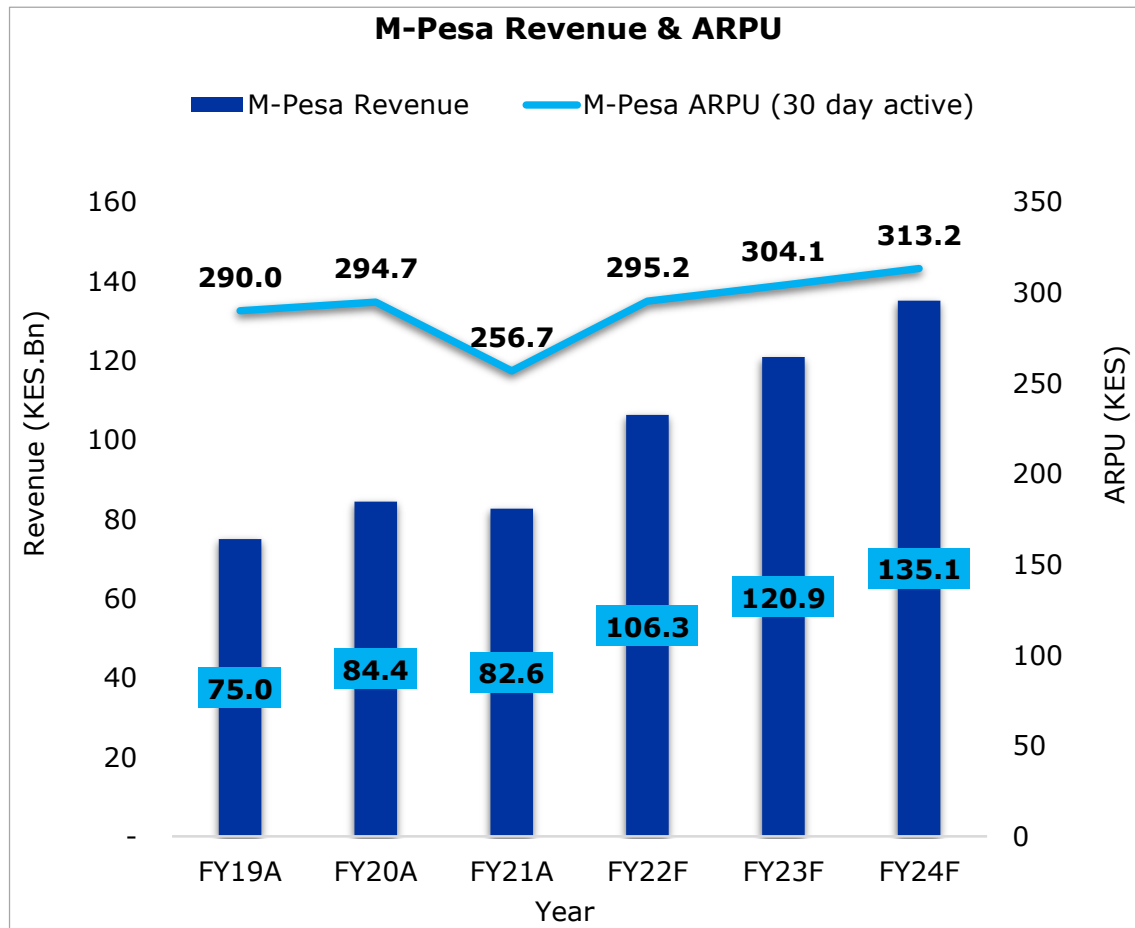


Source: World Bank & Communications Authority

- In May 2021, the Ethiopia Government awarded a telecommunications licence to Safaricom led consortium to operate in the country after submitting a financial bid of KES.91.8Bn (US\$.850Mn).
- The Global Partnership for Ethiopia consortium includes; Safaricom, the Vodacom Group (South Africa), Vodafone (UK), CDC Group (UK), Sumitomo Corporation (Japan) and the Development Finance Corporation.
- The ownership structure of the deal is as follows; Safaricom 56% of the shares, Vodacom & Vodafone 6.2%, Sumitomo Corporation 25% and CDC Group 10%.
- In August 2021, Ethiopia Government included the mobile phone-based financial services in the telco's licence.
- The Safaricom consortia is expected to invest over US\$.8Bn (KES.864Bn) over the next decade.
- The outlook on the investment is positive due to Ethiopia's huge population (115Mn people as at 2020), robust economic growth (averaging 10% in the past 5-years), growth potential with the country's mobile phones penetration rate at 46.1%, extremely favourable demographics and a country that is keen on advancing, currently undertaking a process of economic liberalization.
- State monopoly Ethio Telecom has a head start for voice and recently launched mobile money services but Safaricom and its partners have a wealth of experience in their respective markets to grow its subscriber base and market share.
- Ethio Telecom launched a new mobile financial service called Telebirr in May and within weeks it has 4Mn users, showing the potential of the market.

1) M-Pesa Revenues

Chart.5: Revenues to grow due to increasing ARPU

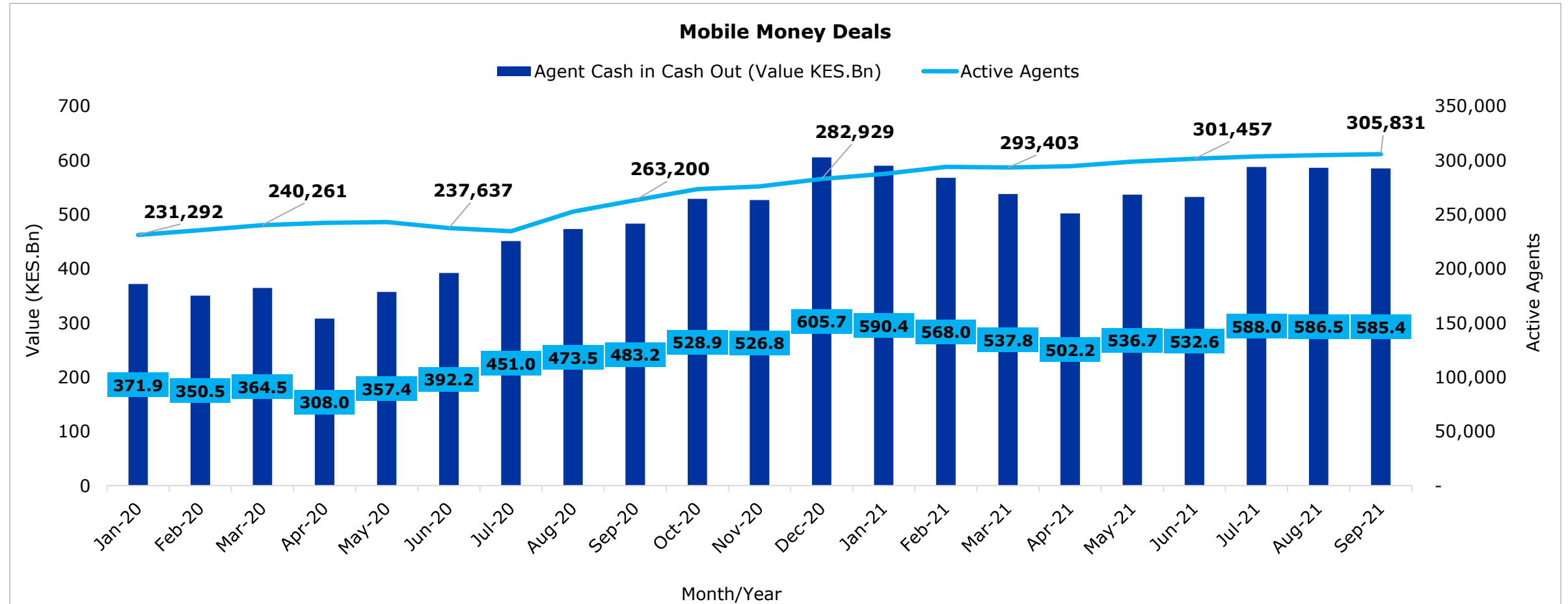


Source: Safaricom Plc Financials & I&M Capital

- We project HY22 M-Pesa revenues to rise by 45.1% to KES.52.1Bn compared to KES.35.9Bn from HY21 (Chart.5).
- M-Pesa revenues dipped by 14.5% in HY21 mainly due to the waiver of fees on person-to-person (P2P) transactions of KES.1,000 and below, bank to M-Pesa wallet (B2C) and M-Pesa to bank wallet (C2B) transfers.
- When the waiver ended at the end of 2020, P2P transactions charges were reduced by 45% for low-value bands below KES.7,500.
- Fuliza has been a big driver of M-Pesa revenues with KES.149.4Bn disbursed via the overdraft facility in HY21 (KES.351.2Bn FY21), contributing KES.2.15Bn (KES.4.5Bn FY21) to M-Pesa revenues.
- We expect M-Pesa revenues to grow 28.6% FY22 to KES.106.3Bn (KES.82.6Bn FY21) driven by increased usage and growth in ARPU to KES.295.2 (KES.256.7 FY21).
- M-Pesa is also projected to be the main revenue earner for Safaricom FY22 with contribution to total service revenue expected to rise to 38.3% compared to 33% FY21.
- According to CA, M-Pesa controls 98.9% market share with 34.3M customers as at June 2021.
- During the same period the telco's registered M-Pesa agents stood at 283,357 (89.9%) compared to 21,277 (7.5%) for Airtel Money and 7,768 (2.7%) for T-Kash.
- Cash handled by mobile money agents rose 41.5% to KES.5.02Tn in the nine months to September 2021 from KES.3.6Tn same period in 2020 (Chart.6).
- The increase in money transactions is positive especially for Safaricom will boost M-Pesa revenues.

Mobile Money Deals

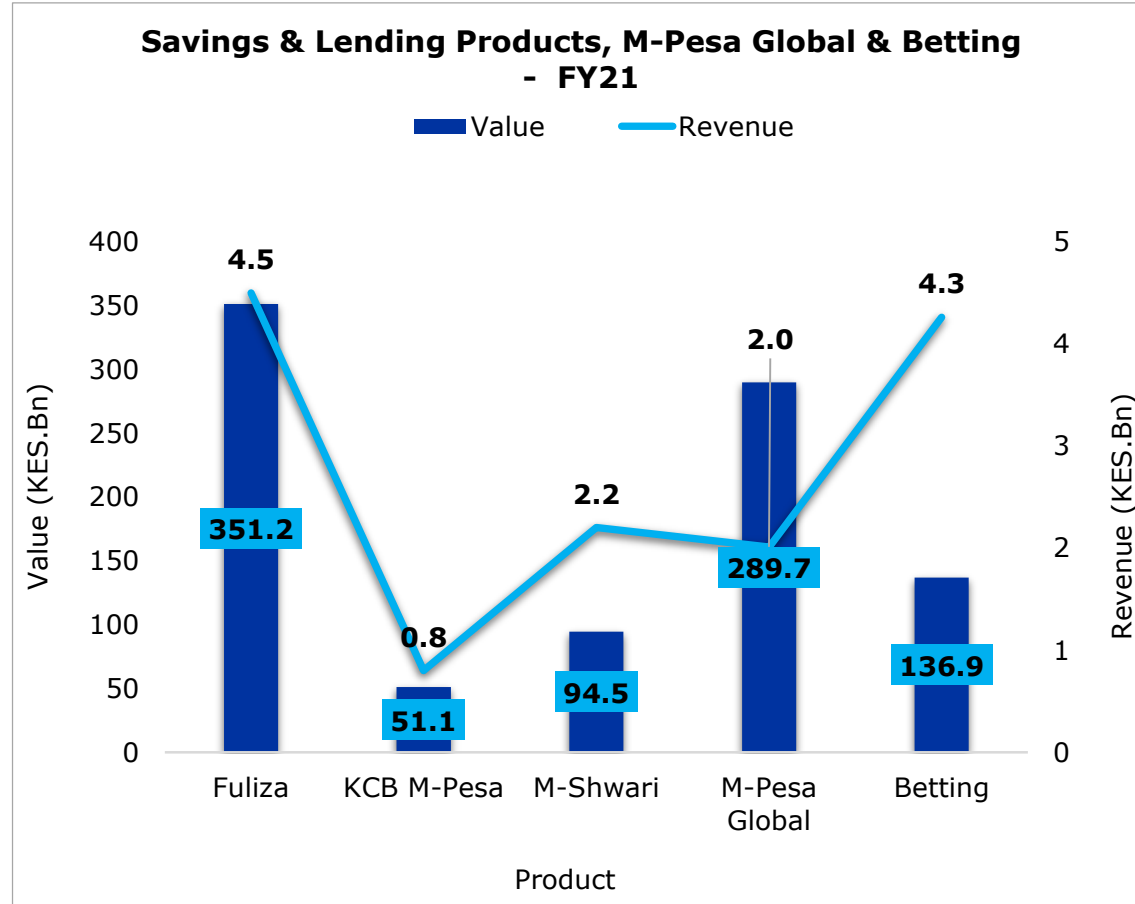
Chart.6: Mobile money deals rise on economic rebound



Source: Central Bank of Kenya

Savings & Lending to boost M-Pesa Revenues

Chart.7: Savings & Lending segment key driver for growth

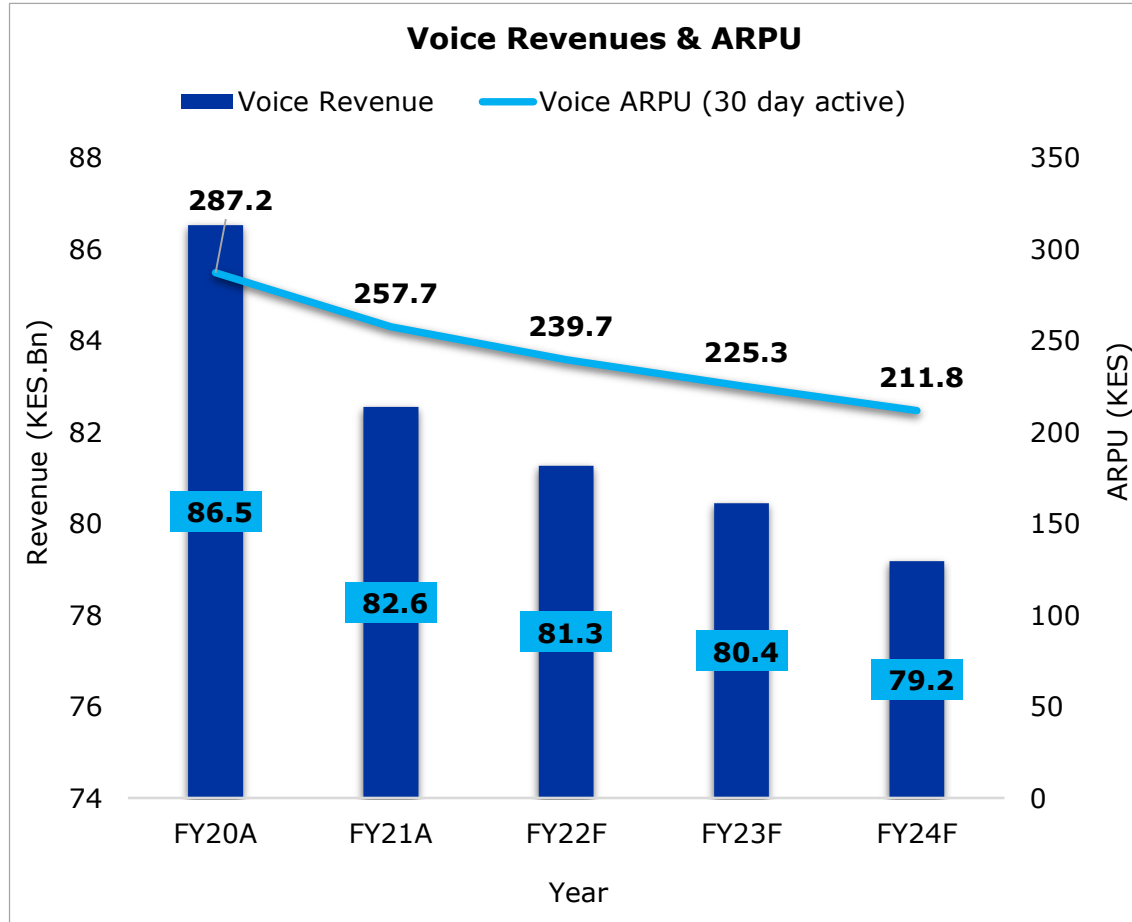


Source: Safaricom Plc Financials

- Safaricom is currently in partnership with NCBA and KCB to provide savings and lending services through M-Shwari, KCB M-Pesa and Fuliza.
- The three platforms disbursed KES.496.8Bn FY21 (KES.490.8Bn FY20), contributing KES.7.5Bn (KES.5.9Bn FY20) to M-Pesa revenues (Chart.7)
- Safaricom facilitates international money transfer through M-Pesa Global. Through this platform, M-Pesa customers are able to send and receive money from countries across the world with current partnerships including; Western Union, MoneyGram, Ria, World Remit, Wave, Remitly among others.
- In FY21, KES.289.7Bn was sent via the platform, contributing KES.2.0Bn to M-Pesa revenues.
- The cumulative remittance inflows rose 19% to US\$.3,530Mn in the 12 months to September compared to US\$.2,967Mn same period in 2020.
- In June 2021, Safaricom launched M-Pesa Super App which is expected to increase M-Pesa Global's market reach and presence among users by providing convenience as well as enhancing their experience.
- The growth in remittances and the new M-Pesa App are expected to drive M-Pesa Global revenues FY22.
- Betting contributed KES.4.3Bn to M-Pesa revenues FY21, a 12.1% growth from KES.3.8Bn FY20.
- With the full resumption of sporting activities in 2021 and the leading gaming player, SportPesa back in business from December 2020, we expect a further growth in betting revenues FY22.

2) Voice Calls Revenues

Chart.8: Voice calls revenues to decline on decreasing ARPU

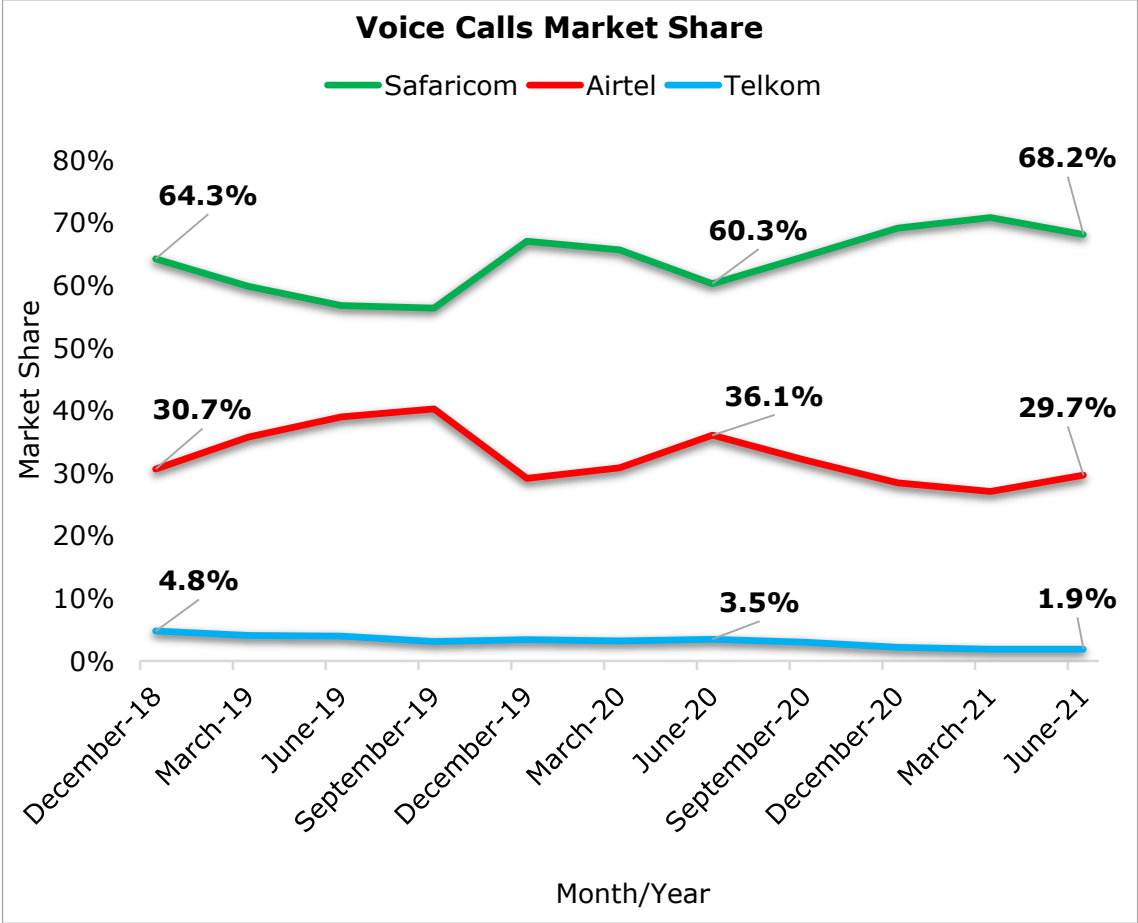


Source: Safaricom Plc Financials & I&M Capital

- We forecast a 0.9% marginal decline in voice revenues HY22 to KES.39.8Bn from KES.40.2Bn in HY21.
- The decrease is due to a decline in ARPU, competition from other market players and migration of customers to newer technologies (over the top services) such as WhatsApp, Skype and Telegram.
- Voice revenues dipped 4.6% in FY21 to KES.82.6Bn (KES.86.5Bn FY20).
- Voice contributed 33% of total service revenue, down from 37.6% the previous year and this is expected to decline further to 29.3% FY22.
- We expect FY22 voice revenues to come in at KES.81.3Bn, a 1.6% drop over the previous year due to the decline in ARPU to KES.239.7 (KES.257.7 FY21) (Chart.8).
- According to CA, Safaricom's share of voice market stood at 68.2% in June 2021 compared to 60.3% same period in 2020. During the same period Airtel and Telkom market share was 29.7% and 1.9% respectively.
- The increase was partly attributed to the telco's brand campaign dubbed 'Twende Tukiuke' as it celebrated its 20th anniversary in 2020.
- The promotion dubbed 20@20 enabled customers to purchase 20 minutes of call time and 20Mbps at KES.20 for 30-days.
- The growth was also boosted by 'Tunukiwa' talk more campaign aimed at customers with low usage.
- However, there was a significant market share drop from 70.9% the previous quarter (Q3 2020/21, January – March 2021) as its rival Airtel ate into its dominance.
- During the quarter Airtel grew its market share by 2.7% to 29.7% as it offered promotions by increasing minutes callers spent on its network.

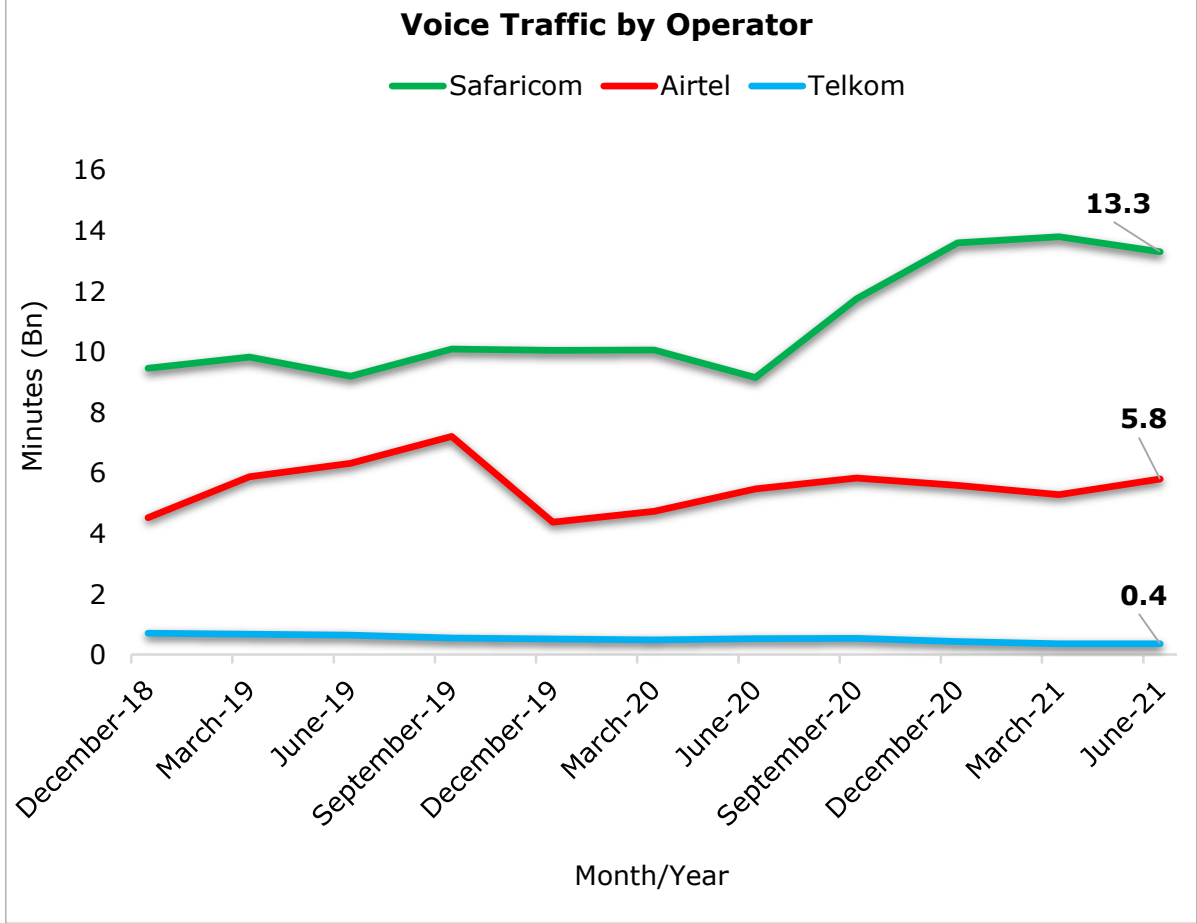
Safaricom's Voice Calls Market Share rises

Chart.9: Voice Calls market share



Source: Communications Authority

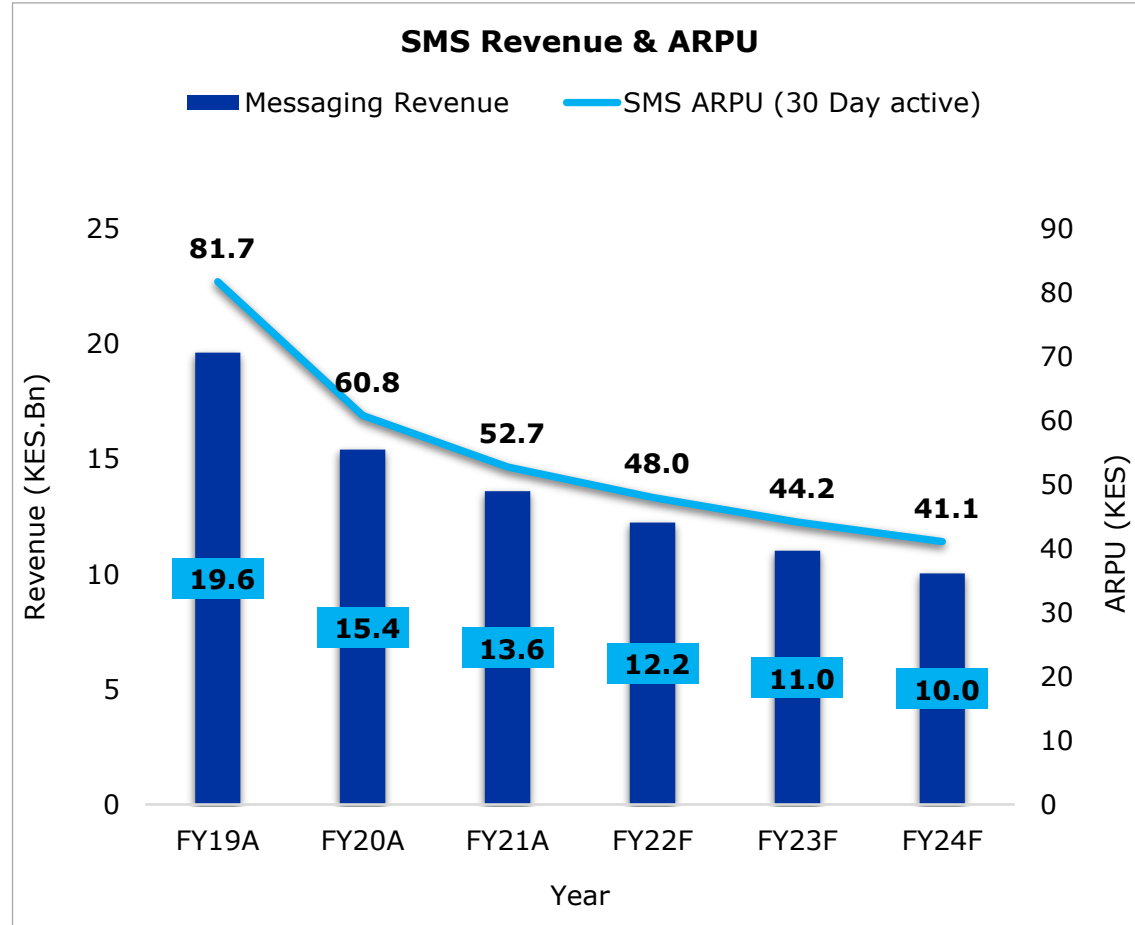
Chart.10: Voice Traffic by Operator



Source: Communications Authority

3) SMS Revenues

Chart.11: SMS revenues declines on OTT competition

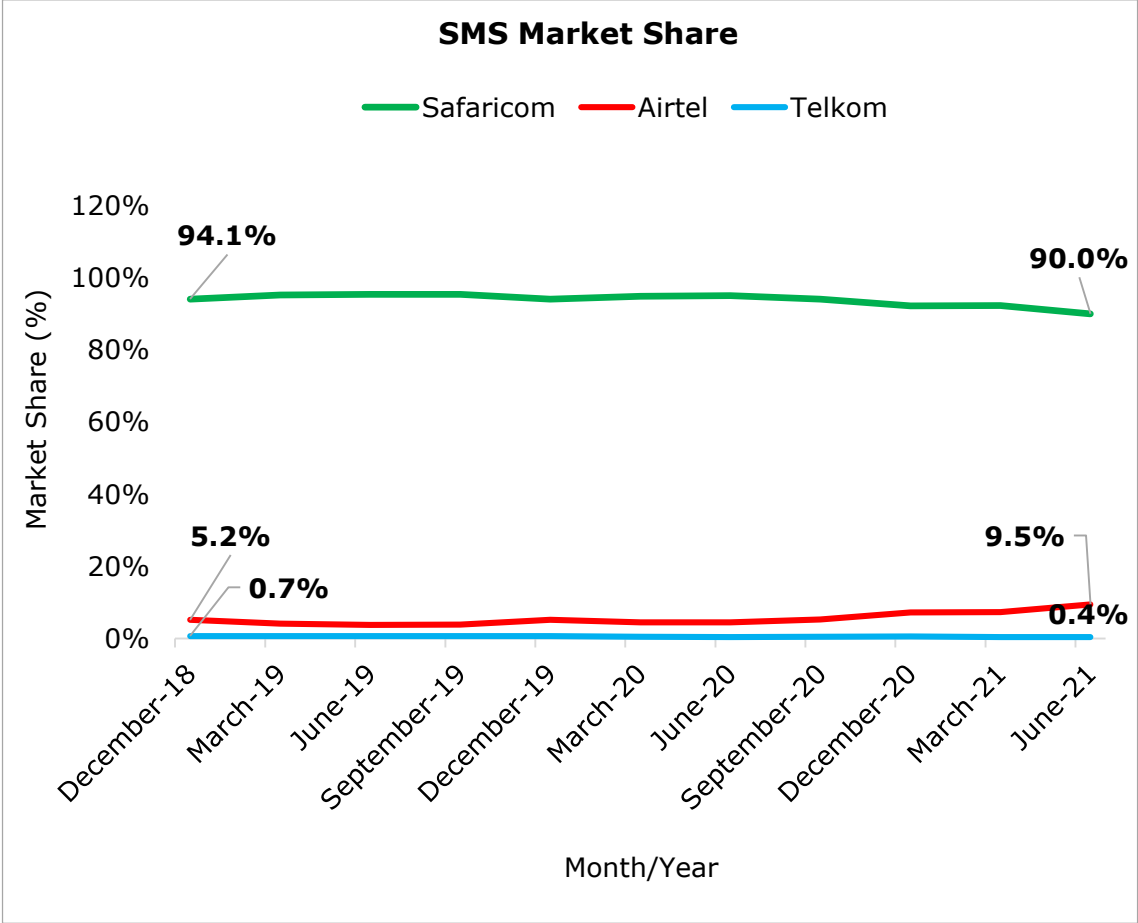


Source: Safaricom Plc Financials & I&M Capital

- Safaricom reported a 6.9% decline in SMS revenues to KES.7.2Bn in HY21 and we expect a further 16.5% decline HY22 to KES.6.0Bn.
- With increased data usage, P2P SMS traffic is expected to decline and for this we project a 10% drop in FY22 SMS revenues to KES.12.2Bn (KES.13.6Bn FY21) (Chart.11).
- SMS revenues contributed 5.4% to total service revenues FY21 and we expect this to decline to 4.4% FY22.
- The telecom industry continues to record declining messaging (SMS) revenues owing to competition from Over the Top (OTT) services like.
- Latest data from CA as at June 2021 shows that the industry's SMS traffic declined to 54.5Bn FY2020/21 from 69.7Bn SMS recorded in FY2019/20.
- During the period, Safaricom's market share in SMS dropped significantly to 92.3% (66.1Bn SMS) compared to 94.9% (50.3Bn SMS) same period the previous year. On the other hand Airtel market share rose from 4.5% (3.1Bn SMS) to 7.2% (3.9Bn SMS).
- In Q4 2020/21 (March – June 2021), Safaricom's SMS market share stood at 90% (Airtel 9.5%), a decline from 92.3% (Airtel 7.3%) the previous quarter.

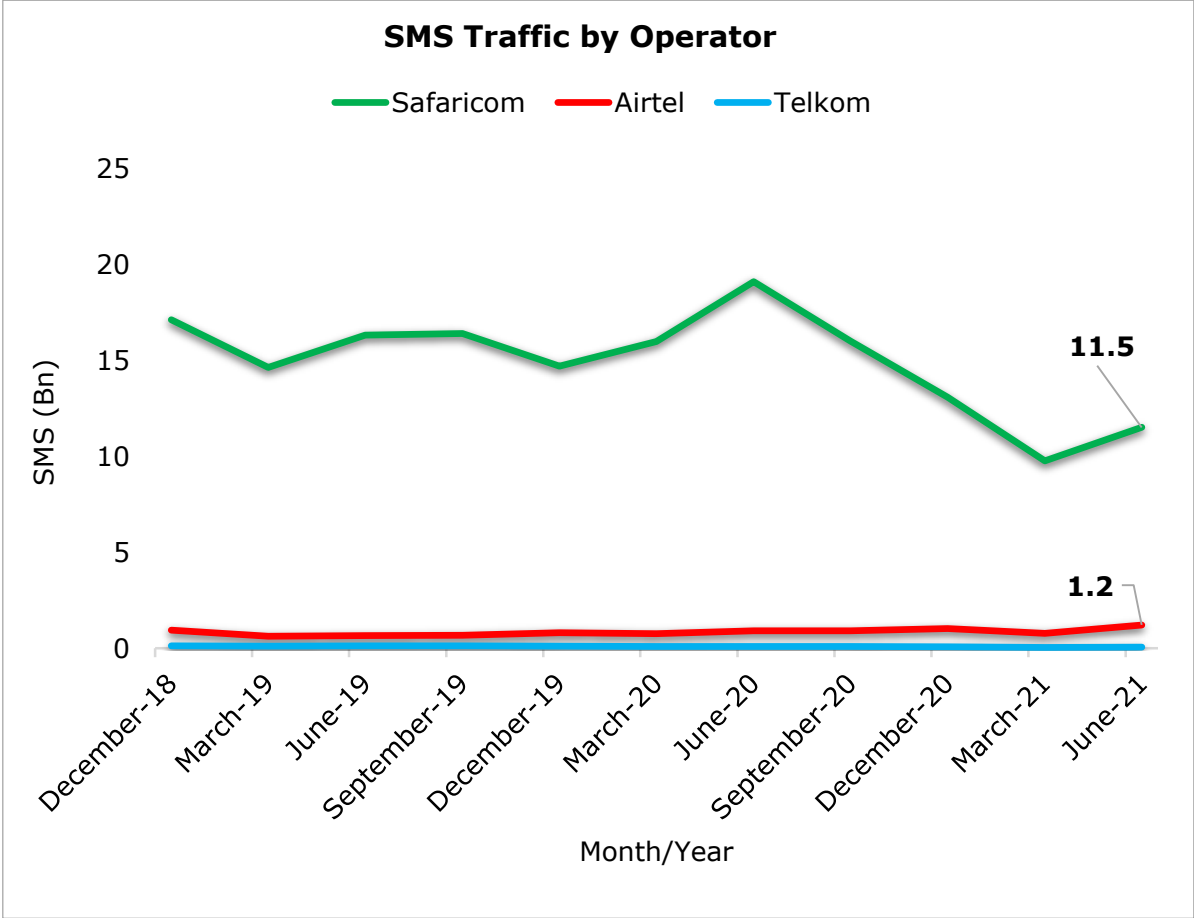
Safaricom Loses SMS Market Share

Chart.12: SCOM’s market share declines to 90%



Source: Communications Authority

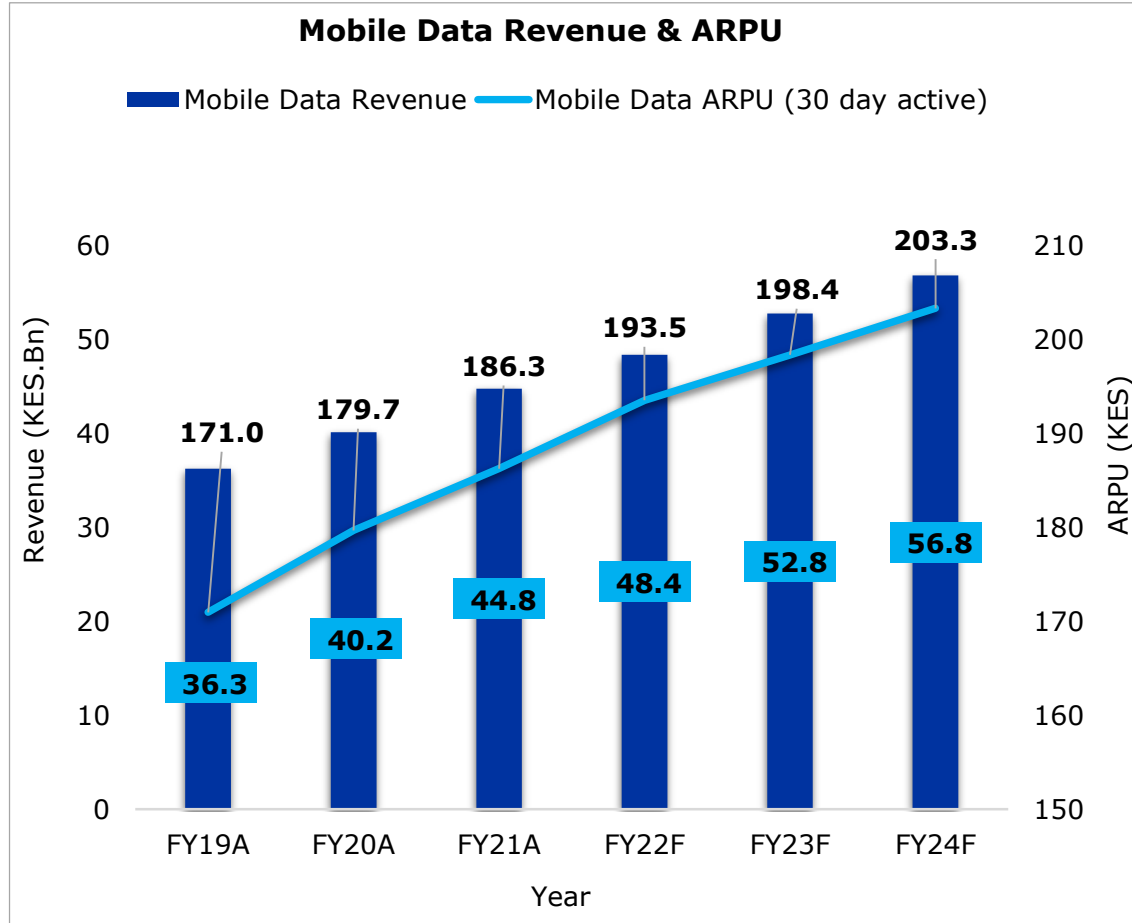
Chart.13: SMS Traffic dips



Source: Communications Authority

4) Mobile Data Revenues

Chart.14: Mobile data revenues fuelled by increased usage

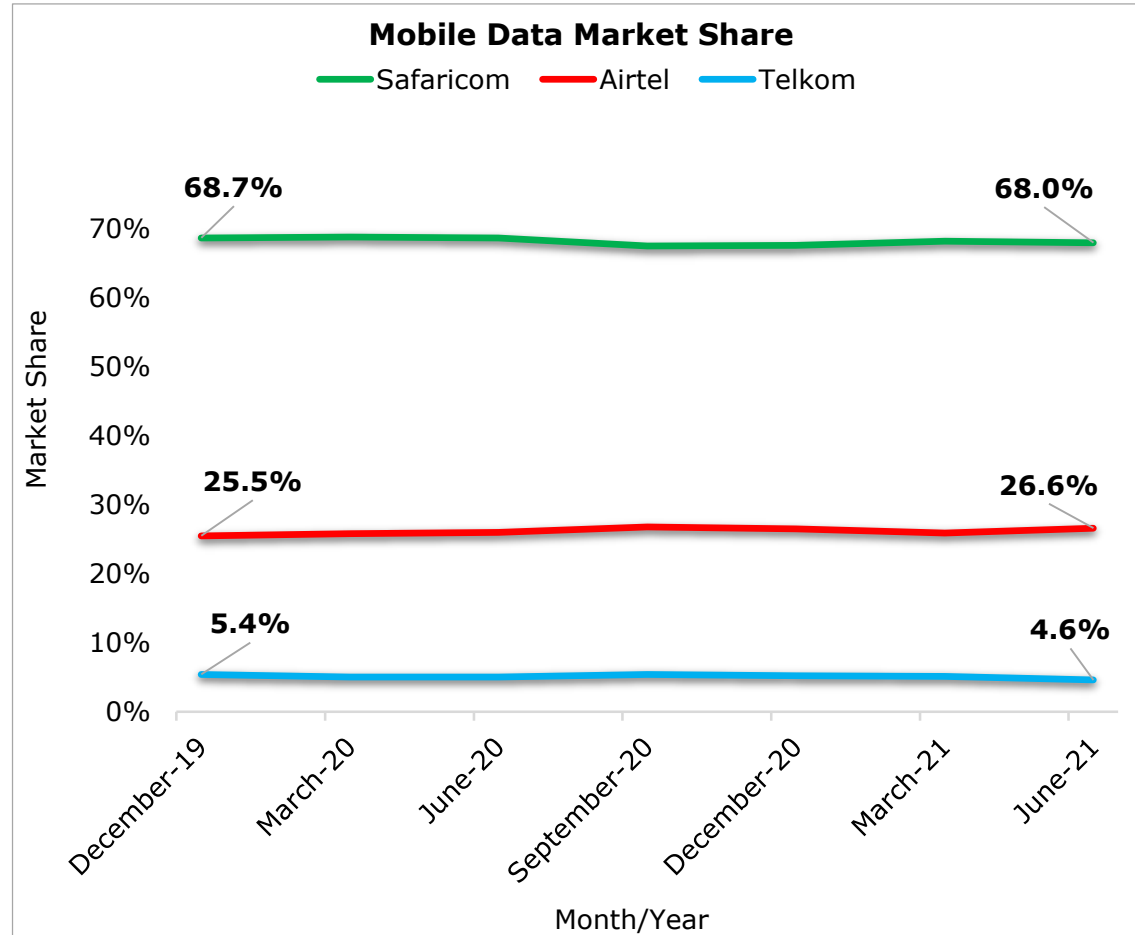


Source: Safaricom Plc Financials & I&M Capital

- Mobile data revenues rose 14.1% in HY21 to KES.22.2Bn and we expect this to hit KES.23.7Bn (+6.7%) HY22.
- We forecast FY22 ARPU at KES.193.9, an increase from KES.186.3 in HY21.
- Our FY22 mobile data revenue projection is KES.48.4Bn (+6%) driven by increased customer subscriptions, smart phone penetration and tech savvy youthful population and the telco's continued investment in 4G and 5G network (Chart.14).
- Safaricom continues to drive data affordability by encouraging bundle usage through price reduction.
- The telco is able to do this through market segmentation and price discrimination to optimize their revenues, and ultimately grow their bottom line.
- We expect mobile data to contribute 17.4% to total service revenue FY22 (17.9% FY21).

Mobile Data Market Share at 68%

Chart.15: 4G penetration and increased subscriptions to grow market share

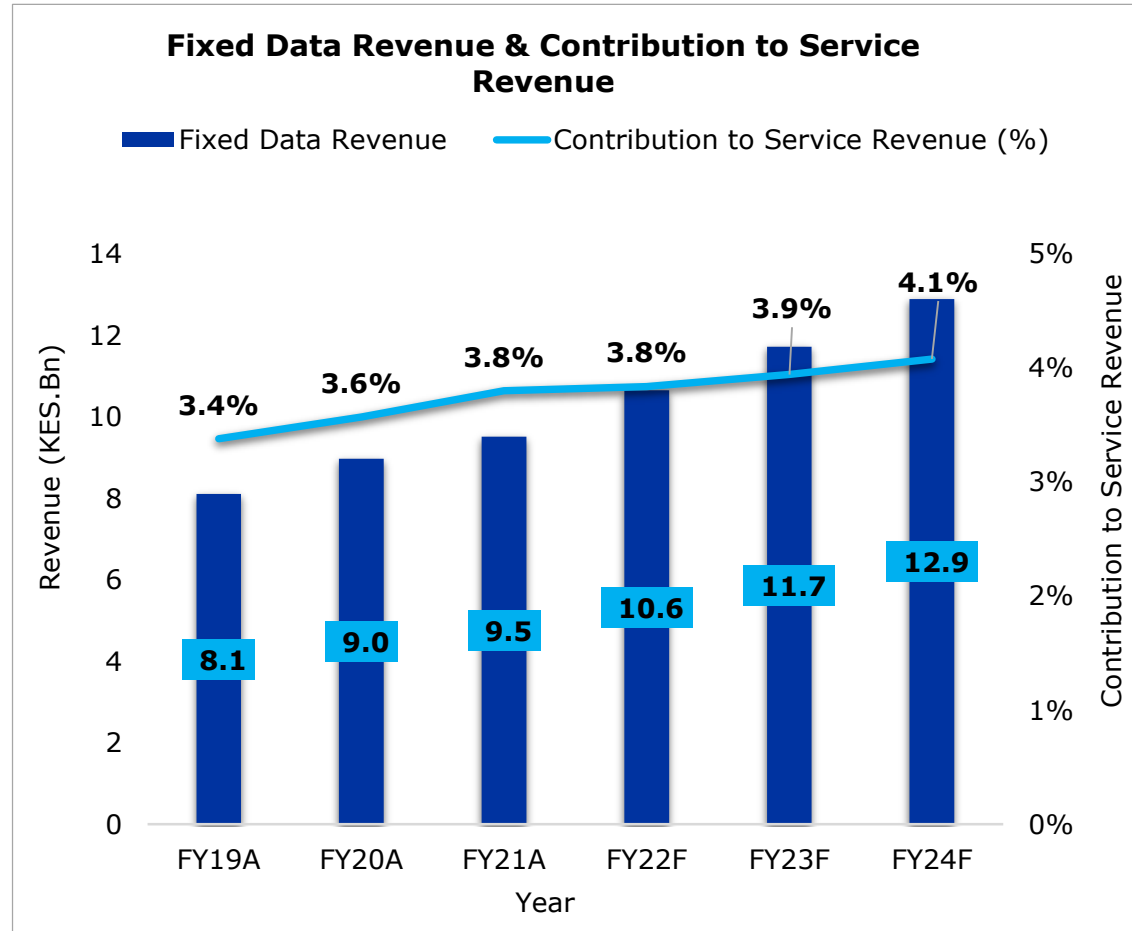


Source: Communications Authority

- Safaricom leads in the market share for mobile data subscriptions at 68% in June 2021, followed by Airtel and Telkom at 26.6% and 4.6% respectively (Chart.15).
- In July 2020, the telco launched the innovative device financing plan dubbed '*Lipa Mdogo Mdogo*' in partnership with Google to give customers still using feature phones an opportunity to own affordable smartphones.
- According to the telco, 250,000 customers (repaying as little as KES.20 a day) took up the smartphones on credit between 28th July 2020 to end of March 2021.
- Data is one of Safaricom's fastest growing revenue lines and we expect the phone credit scheme to boost this service revenues and offset the declining voice calls revenues.
- According to management, the telco plans to increase its 5G sites to 200 by the end of this year from 15 sites launched in March and commercialise the super-fast services in 2022.
- Capital expenditure (Capex) declined by 3.2% FY21 and the company expects this to rise to KES.40Bn FY22.
- At the end of March 2021 the company's 4G base stations rose 24.1% to 5,387 as the company expands 4G coverage across the country.
- Competition from Airtel and Telkom will likely force further price cuts but revenue growth going forward is expected to remain positive.

5) Fixed Data Revenues

Chart.16: Fixed data revenues on an upward trend on growth in uptake

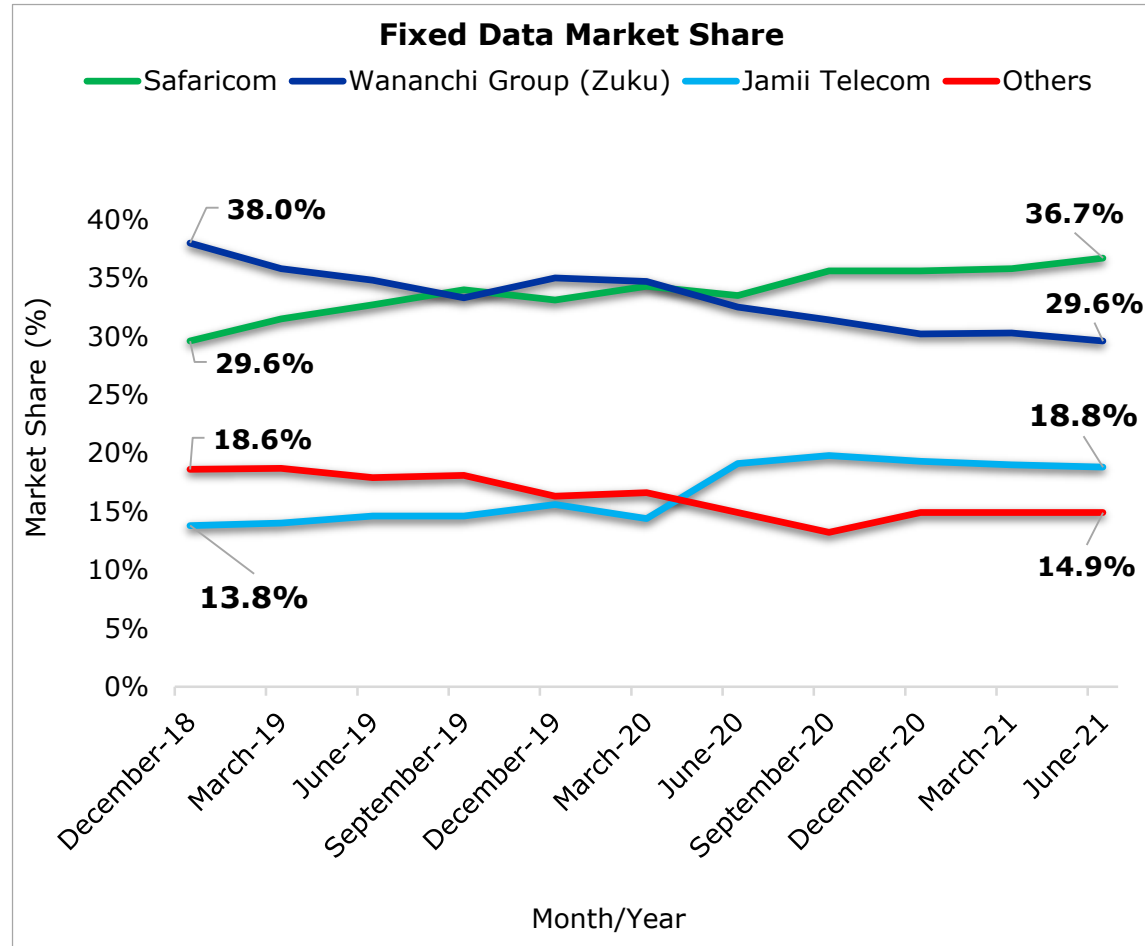


Source: Safaricom Plc Financials & I&M Capital

- We forecast an increase in fixed data revenue to KES.5.2Bn in HY22, a 15% increase from KES.4.5Bn in HY21.
- FY22, fixed data revenue is projected at KES.10.6Bn, a 12% growth compared to KES.9.5Bn FY21 (Chart.16).
- Fixed service revenues contribution is expected to remain flat at 3.8% FY22.
- The continued growth in internet connections due to work from home trends and new emerging business opportunities will drive fixed data revenues going forward.
- In March this year, the company permanently adjusted the bandwidth speeds for their home fiber customers with their diamond customers getting more than double the speed at 250%.
- This is expected to drive the uptake and boost the company's bottom line.

Safaricom Market Share in Fixed Data increases

Chart.17: SCOM market leader in fixed data business



Source: Communications Authority

- As at September 2019, Safaricom overtook Wananchi Group (Zuku) for the first time in number of fixed data connections across the country which was remarkable considering the telco started offering home fiber solutions in 2017 while Zuku has been in operation for more than 10 years.
- In March 2020, Zuku reclaimed the top spot, but that would later on shift back to Safaricom in June the same year as the telco doubled its home fiber bandwidth in April 2020 to support their subscribers working from home.
- Safaricom holds the largest market share in fixed data market at 36.7%, followed by Wananchi Group and Jamii Telkom at 29.6% and 18.8% respectively ~ CA , June 2021 (Chart.17).
- During the same period, the number of data/internet subscriptions stood at 269,397 compared to Wananchi Group's 217,300 and Jamii Telkom's 138,269.
- The telco has significantly grown its market share through network infrastructure expansion, aggressive marketing, improved customer experience and network reliability.
- Huge growth opportunities still exist for the telco to grow its fixed service market share and revenues.

Financial Summary

Income Statement (KES.Bn)	2019A	2020A	2021A	2022F	2023F	2024F
Total Service Revenue	239.8	251.2	250.4	277.6	297.2	316.1
Voice Revenues	95.8	86.5	82.6	81.3	80.4	79.2
Contribution to Service Revenues (%)	40.0%	34.4%	33.0%	29.3%	27.1%	25.1%
SMS Revenues	19.6	15.4	13.6	12.2	11	10
Contribution to Service Revenues (%)	8.2%	6.1%	5.4%	4.4%	3.7%	3.2%
Mobile data Revenues	36.3	40.2	44.8	48.4	52.8	56.8
Contribution to Service Revenues (%)	15.1%	16.0%	17.9%	17.4%	17.8%	18.0%
Fixed service Revenue	8.1	9	9.5	10.6	11.7	12.9
Contribution to Service Revenues (%)	3.4%	3.6%	3.8%	3.8%	3.9%	4.1%
M-Pesa Revenue	75	84.4	82.6	106.3	120.9	135.1
Contribution to Service Revenues (%)	31.3%	33.6%	33.0%	38.3%	40.7%	42.7%
Mobile Incoming Revenue	4.6	8.5	9.5	10.6	11.9	13.3
Other service Revenue	5	7.2	7.8	8.1	8.4	8.8
Non-service Revenue	10.5	11.3	13.7	15.2	16	17
Total Revenue	250.3	262.6	264	292.8	313.2	333
Direct Costs	71.8	74.7	80	84.2	89.5	94.4
Gross Profit	177.9	185.6	180.2	207.6	222.7	237.5
Operating Expenses	53.6	47.6	46	46.7	47.5	48.2
EBITDA	124.3	138	134.1	160.9	175.3	189.3
EBITDA Margin (%)	49.8%	52.6%	50.9%	55.1%	56.1%	57.0%
Depreciation& Amortization	35.3	36.5	38	36.7	39.1	41.8
EBIT	89	101.5	96.2	124.2	136.1	147.5
EBIT Margin (%)	35.6%	38.7%	36.5%	42.5%	43.5%	44.4%
PBT	91.2	105.8	93.6	121.8	133.5	144.6
PAT	62.5	73.7	68.7	85.2	93.4	101.2
EPS	1.56	1.84	1.71	2.13	2.33	2.53
DPS	1.25	1.4	1.37	1.7	1.87	2.02
Special DPS	0.62	-	-	-	-	-

Valuation Summary

Valuation Method	Weighting	Fair Value Price	Weighted Value
1) Free Cash Flow to the Firm (FCFF)	20%	39.72	7.94
2) Free Cash Flow to Equity (FCFE)	20%	41.04	8.21
3) EBITDA Multiple	20%	39.75	7.95
4) P/E Multiple	20%	46.04	9.21
5) Dividend Discount Model	20%	30.77	6.15
Fair Value Estimate (KES)			39.46
Current Price (8 th November, 2021)			40.05
Downside:			-1.5%

Assumptions

- 1) Risk Free Rate (10.02%) – 3 Year Treasury Bond Rate
- 2) Beta = 1.00
- 3) Market Risk Premium = 5.0%
- 4) Cost of Equity = 15.02%
- 5) Cost of Debt = 12.0%
- 6) Terminal growth rate= 9.0% (average growth rate of the company over the last 3-years)
- 7) WACC = 14.38%
- 8) Equal weighting to the five valuation models.

Valuation Summary

Financial Year (KES.Bn)	2019A	2020A	2021A	2022F	2023F	2024F
1) Free Cash Flow to the Firm (FCFF)						
EBIT	89.0	101.5	96.2	124.2	136.1	147.5
Taxes	(28.7)	(32.1)	(25.0)	(36.5)	(40.0)	(43.4)
Net EBIT	60.2	69.4	71.2	87.7	96.1	104.1
Add: Depreciation & Amortisation	35.3	36.5	38.0	36.7	39.1	41.8
Less: Capex	37.3	36.1	35.0	37.3	39.9	42.7
FCFF	58.3	69.8	74.2	87.1	95.3	103.2
Time Period				0.4	1.4	2.4
Discount factor				0.9	0.8	0.7
Terminal Value						1,868.3
PV of Terminal Value						1,354.8
Discounted Values				82.6	79.1	74.9
Sum of discounted values				1,591.3		
No. of outstanding shares				40.1		
Fair Value Estimate (KES)				39.72		
2) Free Cash Flow to Equity (FCFE)						
FCFF	58.3	69.8	74.2	87.1	95.3	103.2
Net borrowing	(0.0)	4.0	6.8	3.4	3.9	4.9
FCFE	58.3	73.8	81.0	90.5	99.2	108.1
Time Period				0.4	1.4	2.4
Discount factor				0.9	0.8	0.7
Terminal Value				-	-	1,956.2
PV Terminal Value						1,399.7
Discounted Values				85.6	81.7	77.3
Sum of discounted values				1,644.3		
No. of outstanding shares				40.1		
Fair Value Estimate (KES)				41.04		

Valuation Summary

Financial Year (KES.Bn)	2019A	2020A	2021A	2022F	2023F	2024F
3) EBITDA Multiple						
EBITDA	124.3	138.0	134.1	160.9	175.3	189.3
Market Capitalization				1,604.6		
Add: Debt				14.8		
Add: Preferred stock				0.0		
Add: Minority Interest				0.0		
Less: Cash				26.7		
Enterprise Value:				1,592.7		
EV/EBITDA (x)				9.9		
No. of outstanding shares				40.1		
Fair Value Estimate (KES)				39.75		
4) P/E Multiple						
Earnings Per share (EPS)	1.56	1.84	1.71	2.13	2.33	2.53
Industry P/E				21.6		
EPS				2.13		
Fair Value Estimate (KES)				46.04		
5) Dividend Discount Model						
Annual Dividends	74.9	56.1	58.9	68.2	74.7	81.0
Time Period				0.39	1.39	2.39
Discount factor				0.95	0.82	0.72
Terminal Value						1,465.7
PV Terminal Value						1,048.8
Discounted Values				64.6	61.5	57.9
Sum of discounted values				1,232.8		
No. of outstanding shares				40.1		
Fair Value Estimate (KES)				30.77		

Disclaimer & Recommendation Guide

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Recommendation Guide:

I&M Capital recommendation guide is based on comparison of Fair Value (FV) of the share and the Current Price (CP) at NSE. Recommendation categories are defined as follow:

- ❑ **BUY:** Reflects an analyst's bullish conviction on a stock. FV above 12% of CP
- ❑ **HOLD:** Reflects an analyst's neutral conviction on a stock. FV between 0% and 11.99% around CP
- ❑ **SELL:** Reflects an analyst's bearish conviction on a stock. FV less than 0% below CP