www.aib-axysafrica.com

Earnings Note

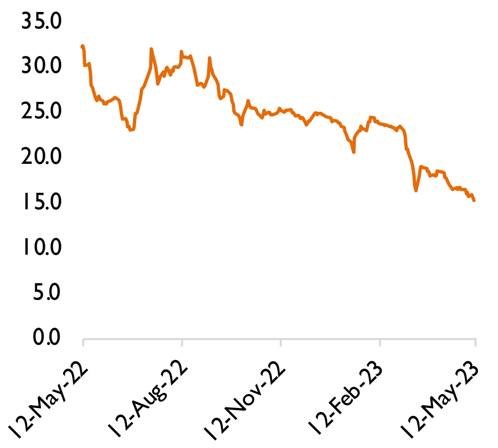
research@aib-axysafrica.com

Company details

NSE Code:	SCOM
Market cap:	588.96Bn
Issued Shares	40.065Bn
52-week high:	KES 32.40
52-week Low	KES 14.70

As at 12th May 2023

Price chart



AIB-AXYS Research, NSE

Historical Price Performance

	1m	3m	6m	12m
Absolute	-20.33%	-38.49%	-41.78%	-51.32%

AIB-AXYS Research, NSE

Research Desk
Solomon Kariuki
Research Analyst

Stacy Makau
Research Analyst

Email: research@aib-axysafrica.com

Stock Update

Result Update

Safaricom PLC FY'23 Earnings Note

Recomm: Buy | **Target Price:** KES 23.71

Summary

- **Safaricom PLC FY'23 PAT declined 22.24% to KES 52.48Bn** driven by a 34.24% increase in operating costs as a result of commencement of full commercial operations in Ethiopia, effects of high inflation and the continued depreciation of the shilling.
- **Revenues increased 4.30% y/y to KES 310.90Bn** which included KES 1.83Bn in revenue from Safaricom Ethiopia. Mpesa revenue increased on the back of increased usage and resumption of wallet to bank and bank to wallet charges. However, a decline in voice revenue was observed due to the effects of downward revision of Mobile Termination Rates(from KES 0.99 to KES 0.58).
- **Earnings per Share (EPS) declined 10.92% to KES 1.55 from KES 1.74 in FY'22** driven by adjustments for Ethiopian operations. A final dividend of KES 0.62 was declared, a decline from KES 0.75 in FY'22, bringing the total dividend for FY'23 to KES 1.20 a decline from KES 1.39 in FY'22.

Key Highlights

- The effects of the commencement of operations in Ethiopia were reflected in the decline in EBIT and an increase in capital expenditure. The overall Capex for FY'23 was KES 96.10Bn (lower than the KES 100-108 Bn guidance), with KES 55.80 Bn spent in Ethiopia for expansion of coverage. Ethiopia 5-Year Capex guidance is USD 1.50-2.00Bn.
- Slow ARPU growth in Kenya business with an increase of 3.47% y/y to KES 750.17 driven by 0.91% increase in 30-day active customers to 33.11Mn.
- Voice revenue declined 2.59% due to effects of reduced Mobile Termination Rate and continuous competition. Additionally, sustained high inflation has affected customers consumption by reducing their disposable income.

Management Commentary

- Management stated they had received a licence to offer mobile financial services in Ethiopia and expressed intentions to launch Mpesa Ethiopia by end of 2023.
- Management except that losses in Ethiopia to peak in FY'24 as a result of increased network coverage and Mpesa roll out.
- Management expect that the revision of Mobile Termination Rate (MTR) is likely to negatively impact voice revenue.

Key Metrics

Particulars	FY23	FY22
Operating Margin	27.34%	36.61%
Return on Equity (ROE)	27.98%	48.40%
Return on Assets (ROA)	10.31%	19.46%
P/E	9.48x	18.62x
P/B	3.14x	9.82x

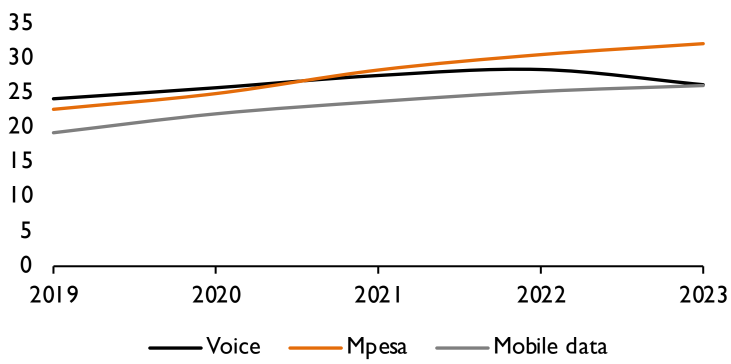
Source: Company; Estimates

Service Revenue

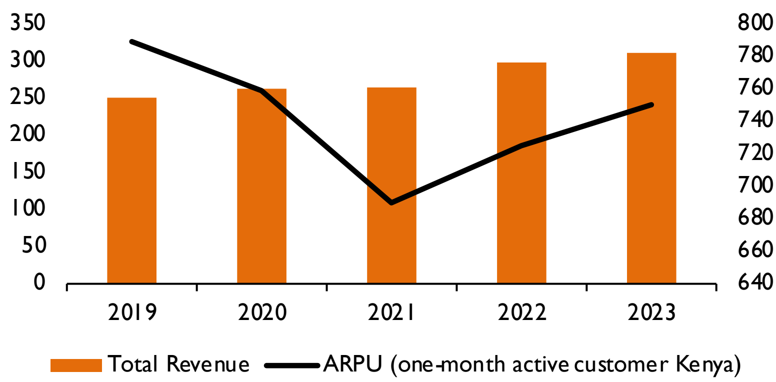
Service revenue recorded an increase of 5.19% y/y to KES 295.69Bn driven by increase in mobile data revenue, Mpesa revenue messaging revenue and other mobile service revenue and underpinned by a decline in voice revenue. Service revenue in Ethiopia stood at KES 564.4 Mn mainly driven by mobile data revenue.

- **Voice and Messaging Revenue –** In line with our expectations, voice revenue decreased by 2.59% y/y to KES 81.05 Bn and active users in Kenya decreased to 26.19 Mn while one-month active voice customer ARPU remained flat at KES 248. Voice revenue continued to remain under pressure as a result of the reduction of MTR and continued competition as customers continuously seek alternative calling methods. Messaging revenue increased by 4.59% y/y to KES 11.38 Bn reversing the five years trend of decreasing revenue. One-month active users in Kenya decreased to 21.17 Mn while ARPU increased by to KES 43.82. We expect voice revenue continuing to remain under pressure in the Kenyan business as a result of alternatives to traditional voice services and the influence of the reduction of MTR. We foresee voice and messaging revenue in Ethiopia growing significantly in tandem with the increase in increase in new customers and smartphone penetration.
- **Data Revenue –** Mobile data revenue increased by 11.38% y/y to KES 53.95Bn with KES 356.5Mn from STE. Active data users increased to 26.07Mn as one-month chargeable data ARPU increased to KES 239.04. This improvement in data revenue is attributable to increased usage (chargeable data per subscriber increased to 3.57GB from 2.32GB) resulting from enhanced affordability of data prices. FFTH customers increased by 17.93% y/y accounting for 1.7% of service revenue. We believe there will be continued increase in data revenue resulting from increased 4G and 5G penetration and ongoing attempts to provide affordable data.
- **Mpesa –** Mpesa revenue increased by 8.82% y/y to KES 117.19Bn and active users increased to 32.11Mn while one-Month active Mpesa ARPU increased KES 311.28. The improvement in revenue was on account of increased usage and resumption of bank to wallet and wallet to bank charges. Mpesa value of transactions increased by 21.38% y/y to KES 35.86 Trn while volume of transactions increased by 33.52% to KES 21.03Bn. Personal payments contributed the largest to Mpesa revenue at KES 78.23Bn while business payments contributed KES 27.47Bn. Financial services contributed KES 8.60Bn while global payments such as remittances contributed KES 2.90Bn. Regarding lending services, the revenue from Fuliza decreased 8.47% y/y to KES 5.40Bn resulting from a decrease in Fuliza costs and the average ticket size declining to KES 298 while the repayment rate stood at 95.70%. KCB Mpesa recorded a 14.29% decrease in revenue to KES 0.6Bn with an average loan size of KES 4,993 and a repayment rate of 95.50%. M-Shwari's revenue increased 10.53% to KES 2.10Bn with an average loan size of KES 7,793 and a repayment rate of 61.70%. We noted with concern, a decline in the repayment rate for all lending services which could point to a challenged credit environment for borrowers. Mpesa global, which enables registered customers to send and receive money globally, recorded an increase of 14.98% in revenue to KES 2.84Bn while value and volume increased by 5.81% and 2.19% respectively. We expect Mpesa revenue growth to be driven by the launch of services in STE, increase in usage of following continuous innovation in digital platforms for businesses and consumers.

Active one-month customers Kenya



Total Revenue and ARPU



Direct costs

Direct costs increased 0.84% y/y to KES 92.23Bn with Kenya recording a 1.10% decrease y/y to KES 90.44Bn while Ethiopia recorded KES 1.80Bn. The increase was on the back of commencement of operations in Ethiopia and a difficult operating and macroeconomic environment. Increase in direct costs was additionally driven by a 9.38% growth in Mpesa commissions in Kenya business to KES 35.60Bn. We expect direct costs to increase as STE operations continue to be scaled up through the recruitment of Mpesa agents.

Operating Expenses

Operating expenses increased by 34.24% y/y to KES 74.09Bn, with Kenya increasing 7.05% to 53.61Bn and Ethiopia closing at KES 19.95Bn. Commencement of operations in Ethiopia, constant high inflation, a depreciating shilling , increased energy costs and increased staff costs led to the increase in operating expenses. Finance costs increased by 10.06% y/y to KES 7.09Bn as the telco continues to rely on debt financing. We observed a significant increase in net foreign exchange losses which we expect will continue to increase as long as the shilling continues to depreciate against major currencies. We foresee increased operating expenses for the group in FY'24 on the back of increased operations in Ethiopia as the telco plans to increase market penetration of their services.

Capital Expenditure (CAPEX)

CAPEX increased by 92.97% y/y to KES 96.10Bn (KES 106.4Bn including hyperinflationary impact) lower than Safaricom's guidance of KES 100-108Bn. Kenya's Capex performance was at KES 40.40Bn a 2.80% y/y increase, in line with FY23 guidance while Ethiopia's capex performance was at KES 55.8Bn. The high Capex was as a result of heavy investments in infrastructure in Ethiopia and expansion of coverage to enhance new growth. We expect the group capex to increase with scaling up of operations by expanding 5G network and transforming into a digital IT network.

Historical Ratios

	FY'2016	FY'2017	FY'2018	FY'2019	FY'2020	FY'2021	FY'2022	FY'2023
EBITDA Margin	42.40%	48.10%	48.17%	49.67%	52.58%	50.80%	50.01%	44.99%
EBIT Margin	28.66%	32.67%	33.84%	35.55%	38.66%	36.42%	36.61%	27.34%
Current ratio	65.17%	46.42%	63.09%	107.99%	86.41%	74.10%	68.04%	75.64%
Quick ratio	14.65%	10.99%	22.98%	64.98%	52.69%	41.18%	36.52%	29.23%
Revenue Growth	19.51%	9.94%	8.74%	6.85%	4.90%	0.56%	12.90%	4.30%
Opex Growth	9.88%	7.18%	5.95%	2.32%	3.99%	7.40%	13.13%	0.84%
PAT Growth	15.56%	26.85%	18.34%	13.03%	17.87%	-6.76%	-1.72%	-22.24%
Payout Ratio	82.77%	83.18%	79.71%	119.89%	76.15%	79.93%	79.89%	77.42%

Competition

The local telco industry is competitive although Safaricom continues to maintain market dominance. Safaricom faces competition from similar service providers such as:

- **Starlink -** Starlink is a satellite internet constellation announced in 2015 with launching of satellites commencing in 2019, operated by Space X, that provides satellite internet access to 45 countries. They have been able to penetrate markets and raise funding through opening of preorders to the public. Starlink offers Satellite Internet Service with a one-time hardware fee for a user terminal and a monthly internet service subscription with service sales capped at a few hundred users per 20km service cell area. Additionally, Starlink also intends to offer Satellite Cellular Services with the aim of providing dead zone cell phone coverage across the US. We expect their satellite internet to rival Safaricom's internet business as their reach is unlimited, they offer faster speeds, usage is unlimited and there is less hardware required for connectivity to their internet service. The drawbacks with Starlink is the expensive initial hardware fee, the monthly charge based on preorder charges is higher than current Safaricom packages and the wait for regulatory approval which could derail expansion plans. The table below outlines the comparison of internet services of Safaricom and Starlink:

Item	Safaricom	Starlink
Installation fee	$30(installation)	$599
Internet Service (>100 Mbps)	$ 125 (Diamond Package)	$ 110
Service sale cap	Capped at individual user consumption (100 Mbps for 1TB of data per day after which it drops to 3Mbps)	Capped at a few hundred users per 20km service cell.

Source: Company Fillings

- **Iristel:** Iristel is a Canadian telecommunication firm that offers offers cutting-edge communication services with a presence in more that 70 countries. The telco runs facilities-based voice networks and communications networks. The telco offers products to businesses in packages such as unified communication (an integrated software that runs business calls, meetings and messaging) , business internet that is customized to organizational need, business voice and cyber security. Additionally, Iristel offers wireless coverage through Ice wireless, Swift and Mobifi packages. Iristel offers wholesale services through voice services for domestic and international local voice, messaging and platform services. Safaricom previously attempted to block the telcos entry into the Kenyan market alleging that Iristel engages in SIM boxing which Safaricom views to be a threat to national security. Iristel Kenya will provide phone and texting services over the internet. We expect their services to rival Safaricom's voice and messaging business as their services will be faster than traditional voice services and more affordable for international calls and bulk calls and messaging. The table below shows some of the prices of packages offered by Iristel:

Product	Plan	Price per month		
			USD	KES
Unified Communication	Standard	$	25.00	3,101.25
Business Internet	Low capacity	$	50.00	6,202.50
	Medium capacity	$	80.00	9,924.00
Mobifi	Park and forward	$	12.00	1,488.60
	Unlimited cross Border	$	59.00	7,318.95

Source: Company

Valuation

At the Current Market Price, the stock is trading at a reasonable valuation of 9.48x P/E compared to the frontier peer average of 12.50x. We continue to prefer Safaricom, given an improving 4G subscriber mix, expected growth in both Mpesa and Data and expansion to Ethiopia. We maintain a BUY recommendation with a downward revised price target of KES 23.71. representing a 61.29% upside.

Outlook

- **Ethiopia** – After a successful launch in October 2022, STE has added 3.00 Mn customers as at the end of March 2023, with coverage now at 22 cities and expectations of 10.00Mn customers by close of FY'24. Operations in Ethiopia offer huge growth prospects as services continue to be rolled out to a country with a large population and a low mobile penetration rate. Ethiopia granting Safaricom a license to launch Mpesa will lead to increased revenue for Safaricom as we view M-PESA as a key contributor to the future growth of the company. We expect increased revenue from STE as operations continue to be scaled up and the continued push to increase mobile penetration. We anticipate Capex spending in STE to moderate to the Kenyan levels as full set up continues. EBITDA in STE will continue being negative in the short-term until breakeven that is anticipated around the fourth-year of operation but could be achieved earlier with Mpesa revenues. We expect net losses to peak in FY'24 resulting from the aggressive expansion expected to be undertaken.
- **Mpesa to Continue Driving Revenue Growth –** We expect Mpesa's growth to come from business payments, resumption of wallet to bank and bank to wallet charges, and a growth in global payments. The M-Pesa App's adoption will continue to spur uptake among both businesses and consumers.
- **Voice Revenue to Remain Challenged** – We expect voice to be the worst affected by regulatory measures such as higher excise duty and reduced MTR where we are likely to see defensive pricing especially in the Kenyan market. Tough macro factors and change in consumer behavior will continue pushing consumers to alternative communication channels leading to data cannibalizing voice revenues.

Key Risks

Kenya Business

a. **Inflationary pressure –** Sustained inflationary pressure which has remained above the CBK's upper target of 7.50%, has continued to shrink consumers wallets consequently lowering consumer purchasing power and spending.

b. **Shilling depreciation** – The shilling has lost 10.92% against the dollar so far in 2023 and the local currency is anticipated to continue coming under pressure as a result of rising dollar demand and declining dollar inflows. The effects of the shilling depreciation are expected to impact debt financing costs.

c. **Adjusted Mobile Termination Rates (MTR) -** The sharp reduction of MTR by the Communications Authority continues to be a threat to voice revenue.

d. **Heavy Taxation-** The Kenyan government's push to expand the tax base is likely to have negative impact on consumer behavior with additional tax effects likely to be passed down to consumers.

e. **Stringent Regulatory environment** – The telco operates in a heavily regulated environment and there are concerns regarding introduction or alteration of regulations that will significantly impact business operations. The imposition of excise duty on sim cards and smartphones is likely to slowdown uptake of 5G.

Ethiopia Business

a. **Political unrest**– Following the signing of a peace treaty in Tigray region, there was the emergence of conflict in Amhara which will negatively impact the economy, affecting STE's operations.

b. **Macroeconomic challenges -** Inflation which is in the 30% levels presents a challenging operating environment , Currency Depreciation with the birr continuously losing ground against the dollar.

c. **Forex Constraints –** The government tightened laws on foreign currency holding and transactions.

d. **Heavy Regulation** – The government places restrictions on social media which could lead to slowdown in data revenue.

Financial Statement Summary

1. Statement of Profit and Loss

Particulars (KES Mn)	FY 22	FY 23	YoY (%)
Total revenue	**298,077.90**	**310,904.80**	**4.30**
Service revenue	281,107.30	295,692.30	5.19
Handsets and other revenue	14,334.00	11,449.80	(20.21)
Other income	2,636.60	3,762.70	42.71
Direct costs	(91,467.80)	(92,232.10)	0.84
Expected credit losses on financial assets	(2,361.20)	(4,725.30)	100.12
Operating expenses	(55,187.00)	(74,085.00)	34.24
EBITDA	**149,061.90**	**139,862.40**	**(6.17)**
Depreciation & Amortisation	(39,933.30)	(54,865.00)	37.39
EBIT	**109,128.60**	**84,997.40**	**(22.11)**
Net finance cost	(6,429.20)	(7,087.10)	10.23
Share of loss of Associates & Joint Venture	(476.00)	(38.20)	(91.96)
Profit before income tax	**102,213.40**	**88,345.20**	**(13.57)**
Tax Expense	(34,717.30)	(35,862.40)	3.30
Profit After Tax	**67,496.10**	**52,482.80**	**(22.24)**
EPS	1.74	1.55	(10.29)
Margins (%)			
Operating Margin	36.60	27.30	(25.41)
Net Profit Margin	22.60	16.90	(25.22)
Tax rate	33.97	40.59	19.49

2. Statement of Financial Position

Particulars (KES Mn)	FY 22	FY 23	% Change
Total Assets	**346,798.60**	**509,207.00**	**46.83**
Non-Current Assets	281,548.60	436,771.50	55.13
Current Assets	65,250.00	72,435.50	11.10
Total Liabilities	**167,097.70**	**245,841.10**	**1.00**
Non-Current Liabilities	68,947.10	105,463.90	52.96
Current Liabilities	98,150.60	140,377.20	43.02
Total Equity	179,700.90	263,365.90	46.56

3. Statement Of Cash Flows

Particulars (KES Mn)	FY 22	FY 23	% Change
Net cash generated from operating activities	110,700.50	116,151.10	4.92
Net cash used in investing activities	-136,944.80	-71,875.60	-47.51
Net cash generated from/(used in) financing activities	30,382.20	-46,864.30	-254.25
Closing cash and cash equivalents	**4,137.90**	**-2,588.90**	**-162.57**

Source: Company; Fillings AIB-AXYS Estimates

Research Desk

Solomon Kariuki
Research Analyst

Stacy Makau
Research Analyst

Email: research@aibaxysafrica.com

Equities Dealing

Nina Goswami

Bernard Kung'u

Bernard Gichuru

Brian Tanui

Samuel Githinji

Sheema Shah

Samuel Wachira

Benson Ngugi

Email: trading@aib-axysafrica.com

Research Desk

Crispus Otieno

Titus Marenye

Aundrina Musyoka

Kenneth Minjire

Disclaimer

AIB-AXYS Africa and its parent company AXYS Group seek to do business with companies covered in their research reports. Consequently, a conflict of interest may arise that could affect the objectivity of this report. This document should only be considered a single factor used by investors in making their investment decisions. The reader should independently evaluate the investment risks and is solely responsible for their investment decisions. The opinions and information portrayed in this report may change without prior notice to investors.

This publication may not be distributed to the public media or quoted or used by the public media without prior and express written consent of AIB-AXYS Africa or AXYS Group.

This document does not constitute an offer, or the solicitation of an offer, for the sale or purchase of any security. Whilst every care has been taken in preparing this document, no representation, warranty or undertaking (express or implied) is given and no responsibility or liability is accepted by AIB-AXYS Africa or any of its employees as to the accuracy of the information contained and opinions expressed in this report.