

DYER & BLAIR INVESTMENT BANK

EARNINGS UPDATE

Founder Member of the Nairobi Securities Exchange

30TH APRIL 2020



DYER & BLAIR
INVESTMENT BANK

WE KNOW. YOU KNOW.

SAFARICOM LIMITED: FY20 EARNINGS UPDATE

Dear All,

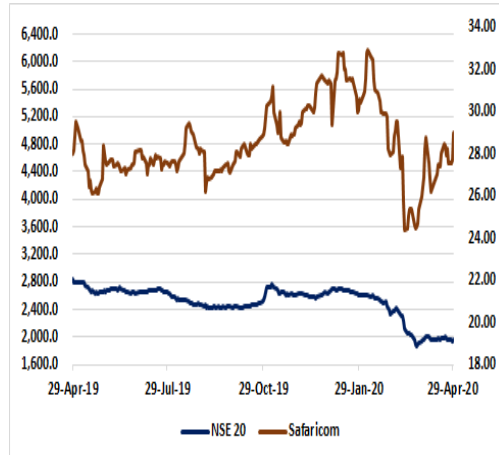
Safaricom Limited (Safaricom) announced its FY20 results, recording a 19.5% y-o-y growth in PAT to KES 74.71 BN. EPS rose 19.2% y-o-y to KES 1.86. Headline EPS (excluding a one-off gain from the acquisition of the M-PESA brand) rose to KES 1.78. EBIT rose 13.5% y-o-y to KES 101.01 BN above management's guidance of KES 93-97 BN. The Directors recommend a final dividend per share of KES 1.40, up from KES 1.25 in FY19.

Below please find key highlights:

Service revenue rose 4.8% y-o-y to KES 251.2 BN on the back of continued growth in non-voice revenue (mainly M-PESA and Data). On an underlying basis (adjusted for the one-off gain from the acquisition of M-PESA brand), service revenue grew 5.9% y-o-y. That said, service revenue growth was partially offset by the COVID-19 response and a contraction of the betting industry. Specifically, the no fee concession of P2P transfers of amounts below KES 1,000 saw a hit of KES 0.6 BN (March 2020) while the contraction of the betting industry saw an impact of KES 1.9 BN. Management estimates that the no-fee concession will have an impact of about KES 5.5 BN over the initial 90 days to June 30th 2020.

Voice revenue declined 1.4% y-o-y to KES 94.45 BN and contributed 37.4% of service revenue, down 240 bps y-o-y. This was followed a 6.6% y-o-y rise in 30 day active voice customers that alongside the revenue decline saw the 30 day active voice ARPU decline 7.3% y-o-y to KES 305.66. As mobile penetration rate has already crossed the 100% mark, and as customer demographics will continue to drive cannibalization of voice by data, we expect this trend to continue. While it is possible that continued COVID-19 related quarantine measures will drive more talk time, we expect this cannibalization to continue in favor of fixed data revenue.

SAFARICOM: 52 WEEK PRICE PERFORMANCE



(Source: NSE, DBIB Research)

PRICE	ABSOLUTE	EXCESS
RETURN	RETURN	RETURN
3 months(%)	(5.2)	19.2
6 months(%)	(4.3)	23.8
12 months(%)	3.6	34.1

KEY METRICS

Current Price (KES)	29.00
52 week Range (KES)	24.35-32.90
YTD Return (%)	(7.9)
Issued Shares (Mn)	40,065.4
Market Cap (USD Mn)	10,830.5
Enterprise Value (USD Mn)	10,655.6

Recommendation	Hold
Trailing EPS (KES)	1.86
EV/EBITDA (x)	8.5
P/E (x)	15.6
P/FCF (x)	16.5
P/CFO (x)	11.6
Div. Yld (%)	6.4

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M-PESA revenue rose 12.6% y-o-y rise to KES 84.4 BN and contributed 33.6% to service revenue, up 230 bps y-o-y. This followed a 10.0% increase in the 30 day active M-PESA customers to 24.9 MN and a 5.3% y-o-y rise in chargeable transactions to 12.9 per customer per month (chargeable transactions excluding betting rose 21.0% y-o-y to 10.7) which together saw 30 day M-PESA ARPU rise 2.3% to KES 282.5.

M-PESA growth was mainly driven by the savings & lending and P2P which together accounted for circa two thirds of total growth. Management has observed a slow down in the growth rates of withdrawals and payments, partly driven by a general economic slow down and are concerned that these trends could worsen as we face the COVID-19 pandemic in FY21. On the plus side, these developments continue to anchor M-PESA's transition into a wallet setting the stage for an increased velocity of transactions within the platform as more use cases are developed.

Mobile data revenue rose 12.1% y-o-y to KES 40.7 BN and contributed 16.2% to service revenue, up 110 bps y-o-y. This was on the back of a 14.2% y-o-y rise in the number of 30 day active mobile data customers to 22.0 MN. However, 30 day mobile data ARPU declined 10.0% y-o-y to KES 154.1 partly due to a 28.3% reduction in the effective rate per MB. There remains a significant room for growth as the number of 30 day active overall customers stand at 28.6 MN vis-à-vis the number of 30 day mobile data customers (22.0 MN).

SMS revenue continued its decline with a drop of 12.3% y-o-y to KES 17.2 BN despite a 20.2% y-o-y rise in 30 day active SMS customers to 21.4 MN. 30 day active SMS ARPU declined 17.7% y-o-y to KES 66.94.

Fixed data revenue rose 10.7% y-o-y to KES 8.9 BN and is expected to continue on a strong growth path as management scales its Fibre to the Home (FTTH) and Fibre to the Building products (FTTB).

EBITDA margin rose 146 bps y-o-y to 51.3% on the back of a 4.3% y-o-y growth in contribution to KES 185.6 BN (contribution margin of 70.7%) and a 4.9% y-o-y decline in operating costs to KES 50.9 BN driven by a 22.6% y-o-y decline in sales and advertising costs that arose from operational and digital efficiencies.

Capital intensity declined 1.1 ppts to 13.8% following a 3.1% y-o-y decline in capital additions to KES 36.1 BN as management continue to focus on enhancing monetization and cost savings opportunities upon deployment.

Free cash flow rose 11.4% y-o-y to KES 70.3 BN up from KES 63.1 BN in FY19 driven by higher net income from fixed deposits and T-bills investments.

4G base stations rose by 55.6% y-o-y to 4,342 courtesy of Safaricom's policy of 4G everywhere. In order to complement its spectrum refarming (moving more bandwidth from 2G and 3G to 4G), Safaricom, in partnership with Google and Teleone, will launch a 4G device financing program dubbed 'Lipa Mdogo Mdogo' that aims to support the low-income consumer to cop a 4G-enabled smartphone at an affordable price.

The company reported a KES 3.3 BN one off gain following the acquisition of M-PESA brand through a Joint Venture with Vodacom. Going forward, Safaricom and Vodacom will leverage the JV to pursue M-PESA expansion opportunities across Africa. Both Safaricom and Vodacom subsidiaries that use M-PESA will continue to pay royalty to the JV at the typical rate of 2% and 5% respectively, whereas Safaricom and Vodacom will share the JV's expenses and profits on a 50/50 basis.

Safaricom, alongside Vodafone and Vodacom, continues to pursue the opportunity in Ethiopia as a consortium with external parties that bring in various strengths. Owing to the COVID pandemic and other challenges, the bidding process might over-run into next year as opposed to mid-year 2020 as per the initial plan. Following the recent Ethiopian central bank directive, foreign-owned institutions are prohibited from offering mobile money services. This might prove difficult for Safaricom's pursuit unless via partnership with the currently state-owned Ethio Telecom, subject to its privatization.

Going forward: Management postponed FY21 guidance to 2Q21 due to uncertainties occasioned by the COVID-19 pandemic with Kenya's case numbers suggesting that she may be early in the cycle thus making it difficult to forecast the tapering of ongoing containment and prevention measures. Still, management highlighted 4 possible tailwinds namely: opportunity to further shift away from cash, increase uptake of mobile data, increased penetration of fixed connectivity and enhanced customer loyalty as well as 4 possible headwinds namely: economic growth slow down, pressure on consumer wallet, interest rates and currency devaluation and reduced government income.

On a trailing basis, Safaricom is trading at a P/E of 15.6x, P/FCF of 16.5x and P/CFO of 11.6x. We issue a **Hold** recommendation.

PROFIT AND LOSS SUMMARY (KES BN)

Year End: March	FY20	FY19	y-y % ch	2H20	1H20	2H19	y-y % ch	h-h % ch
Voice revenue	94.45	95.80	(1.4)	47.58	46.87	48.41	(1.7)	1.5
Messaging revenue	17.19	19.61	(12.3)	8.59	8.60	7.83	9.7	(0.1)
Mobile Data revenue	40.67	36.27	12.1	20.89	19.78	19.68	6.1	5.6
Fixed Data revenue	8.97	8.10	10.7	4.42	4.55	4.35	1.6	(2.9)
M-PESA revenue	84.44	74.99	12.6	42.47	41.97	39.47	7.6	1.2
Other service revenue	5.50	5.00	10.0	2.95	2.55	2.51	17.5	15.7
Service revenue	251.22	239.77	4.8	126.90	124.32	122.26	3.8	2.1
Handset and other revenue	10.48	9.45	10.9	5.32	5.16	4.97	7.0	3.1
Construction revenue	0.58	0.60	(3.3)	0.23	0.35	0.30	-	(34.29)
Total Revenue	262.28	249.82	5.0	132.45	129.83	127.83	3.6	2.0
Other income	0.28	0.46	(39.1)	0.21	0.07	0.46	(54.3)	-
Direct costs	(74.70)	(71.80)	4.0	(37.22)	(37.48)	(36.86)	1.0	(0.7)
Construction costs	(0.58)	(0.60)	(3.3)	(0.23)	(0.35)	(0.30)	-	(34.3)
Provision for ECLs on receivables	(1.67)	0.01	N_A	(1.67)	-	90.96	1.00	-
Contribution	185.61	177.89	4.3	93.54	92.07	90.96	2.8	1.6
Operating Costs	(50.97)	(53.59)	(4.9)	(25.38)	(25.59)	(27.83)	(8.8)	(0.8)
Forex gain/(loss) on trading activities	-	-	-	(0.02)	0.02	0.03	(166.7)	(200.0)
EBITDA	134.64	124.30	8.3	68.14	66.50	63.15	7.9	2.5
Depreciation & amortization	(33.62)	(35.33)	(4.8)	(16.95)	(16.67)	(17.77)	(4.6)	1.7
Net financing income/ (costs)	2.56	2.24	14.3	0.71	1.85	0.83	(14.5)	(61.6)
Associate & JV share of (loss)/profits	3.36	0.01	N_A	3.31	0.05	0.02	0.0	N_A
PBT	106.94	91.22	17.2	55.21	51.73	46.23	19.4	6.7
Taxation	(32.23)	(28.72)	12.2	(16.16)	(16.07)	(14.00)	15.4	0.6
Net Income	74.71	62.50	19.5	39.05	35.66	32.23	21.2	9.5
EPS	1.86	1.56	19.2	0.97	0.89	0.80	20.9	9.0
Trailing EPS	1.86	1.58	17.7	0.17	1.69	0.08	120.4	(90.1)
DPS	1.40	1.25	12.0	1.40	-	1.25	-	-

(Source: Company, DBIB Research)

CASHFLOW SUMMARY (KES BN)

Year End: March	FY20	1H20	FY19	y-y % ch	h-h % ch
EBITDA	134.63	66.50	124.30	8.3	102.5
Working Capital Movement	1.25	2.94	1.15	8.7	(57.5)
Capital Additions	(36.10)	(18.11)	(37.25)	(3.1)	99.3
Movement in contract liabilities	0.00	(0.01)	0.00	-	(100.0)
Operating free cash flow	99.80	51.32	88.45	12.8	94.5
Interest received/(paid)	2.59	2.12	2.12	22.2	22.2
Taxation paid	(32.11)	(15.77)	(27.46)	16.9	103.6
Free cash flow	70.27	37.35	63.11	11.3	88.1

(Source: Company, DBIB Research)

BALANCE SHEET SUMMARY (KES BN)

Year End: March	FY20	1H20	FY19	y-y % ch	h-h % ch
Equity and non-controlling interest	144.12	105.07	144.35	(0.2)	37.2
Borrowings	-	0.00	0.00	-	-
Capital employed	144.12	105.07	144.35	(0.2)	37.2
Non-current assets	149.17	144.01	142.52	4.7	3.6
Contract assets	2.56	2.36	1.99	-	-
Inventories	1.86	1.98	1.78	4.5	(6.1)
Receivables and prepayments	18.36	20.30	18.13	1.3	(9.6)
Cash and cash equivalents	26.76	23.28	20.03	33.6	14.9
Current assets	49.87	67.17	49.97	(0.2)	(25.8)
Contract liabilities	9.41	9.89	9.28	1.4	(4.9)
Provisions	4.46	3.72	3.89	14.7	19.9
Dividend payable	1.05	56.14	0.00	-	-
Payables and accrued expenses	29.92	33.79	28.70	4.3	(11.5)
Borrowings	8.00	0.00	4.03	98.5	-
Current income tax	0.11	0.81	0.35	(68.6)	(86.4)
Current liabilities	52.95	104.35	46.25	14.5	(49.3)
Net current liabilities	(3.08)	(37.18)	3.72	(182.8)	(91.7)
Net assets	146.09	106.83	146.24	(0.1)	36.7

(Source: Company, DBIB Research)

SUBSCRIBER STATISTICS

	FY20	1H20	FY19	y-y % ch	h-h % ch
Total Customers (MN)	35.61	34.57	31.73	12.2	3.0
30 day active Customers (MN)	28.63	27.45	26.15	9.5	4.3
30 day active Voice Customers (MN)	25.75	24.90	24.16	6.6	3.4
30 day active SMS Customers (MN)	21.40	18.36	17.81	20.2	16.6
M-PESA Customers (MN)	-	-	-	-	-
30 day active MPESA Customers (MN)	24.91	23.61	22.64	10.0	5.5
30 day active mobile data Customers (MN)	21.99	20.19	19.26	14.2	8.9

(Source: Company)

	FY20	1H20	FY19	y-y % ch	h-h % ch
Voice ARPUs**	221.03	112.98	251.02	(11.9)	95.6
30 day active Voice ARPU**	305.66	156.86	329.83	(7.3)	94.9
SMS ARPUs**	40.23	20.73	45.79	(12.1)	94.0
30 day active SMS ARPU**	66.94	39.03	81.38	(17.7)	71.5
M-PESA ARPUs**	-	-	-	-	-
30 day active MPESA ARPU**	282.48	148.14	276.02	2.3	90.7
30 day active Data ARPU**	154.12	81.64	171.22	(10.0)	88.8
Fixed Data ARPUs**	-	-	-	-	-
30 day active Fixed ARPU**	-	-	-	-	-
Service ARPU**	587.90	299.68	628.75	(6.5)	96.2
30 day active Service ARPU**	731.23	377.41	749.19	(2.4)	93.7

**In-house Calculations may differ from Safaricom's figures

(Source: DBIB Research)

OPERATING PERFORMANCE

	FY20	1H20	FY19	y-y bps ch	h-h bps ch
Contribution margin (%)	70.7	70.9	71.1	(45)	(19)
EBITDA margin (%)	51.3	51.2	49.9	146	11
EBIT margin (%)	38.5	38.4	35.7	277	11
Pretax margin (%)	40.7	39.8	36.6	412	2.3
PAT margin (%)	28.5	27.5	25.3	12.6	3.7
Asset Turnover (x)	1.8	0.9	1.8	(0.0)	95.1
Inventory Turnover (x)	141.2	65.6	141.0	0.1	115.2
Receivables Turnover (x)	14.3	6.4	13.8	3.3	123.5
Payables Turnover (x)	8.8	3.8	8.7	0.4	128.3
Working capital turnover (x)	2.6	0.8	2.6	(2.1)	237.2

(Source: DBIB Research)

INVESTMENT RETURNS

	FY20	1H20*	FY19	y-y bps ch	h-h bps ch
RoA	37.5	16.9	32.9	14.0	122.3
RoE	51.8	33.9	43.9	18.0	52.7
RoIC	51.8	33.9	43.9	18.0	52.7

*Annualized

(Source: DBIB Research)

FINANCIAL STABILITY

	FY20	1H20	FY19	y-y ch	h-h ch
Net debt/(cash) (KES MN)	(18,760.0)	(23,280.0)	(16,000.0)	17.3	(19.4)
Net debt (cash)/equity (%)	(13.0)	(22.2)	(11.1)	17.3	(41.3)
Net debt (cash)/EV (%)	(1.6)	(2.0)	(1.4)	17.3	(19.4)
EV/EBIT (x)	11.3	11.9	13.2	(14.4)	(4.9)
EV/EBITDA (x)	8.5	9.0	9.5	(10.4)	(5.7)
EV/Subscriber (x)	32,101.6	33,067.3	35,891.3	(10.6)	(2.9)
Current ratio (x)	0.9	0.6	1.1	(12.8)	46.3
Interest cover (x)	52.6	35.9	55.8	(5.7)	46.3
Adj cash int cover (x)	52.6	35.9	55.8	(5.7)	46.3
Debt/cash flow (x)	0.1	-	0.1	78.3	-
Debt/CFO (x)	0.1	-	0.0	-	-
Net debt (cash)/share (KES)	(0.47)	(0.6)	(0.4)	17.3	(19.4)
Book value/share (KES)	3.60	2.6	3.6	(0.2)	37.2
Payout ratio (%)	75.3	-	79.1	(4.9)	-

(Source: DBIB Research)

APPENDIX

COMPANY INVESTMENT RATINGS

Buy: Share price may generate more than 15.0% upside over the next 12 months

Overweight: Share price may generate between 5.0% and 15.0% upside over the next 12 months

Hold: Share price may fall within the range of <+5.0/ -10.0% over the next 12 months

Take Profit: Target price has been attained. Look to accumulate at lower levels. Company fundamentals however remain strong

Underweight: Share price may generate between 10.0% and 15.0% downside over the next 12 months

Sell: Share price may generate more than 15.0% downside over the next 12 months, significant business and/or financial risks present, industry concerns

Not Rated: Counter is not within regular research coverage

SECTOR INVESTMENT RATINGS

Overweight: Industry performance better than that of the whole market

Equal weight: Industry performance about the same as that of the whole market

Underweight: Industry performance worse than that of the whole market

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