

Safaricom Plc Company Update

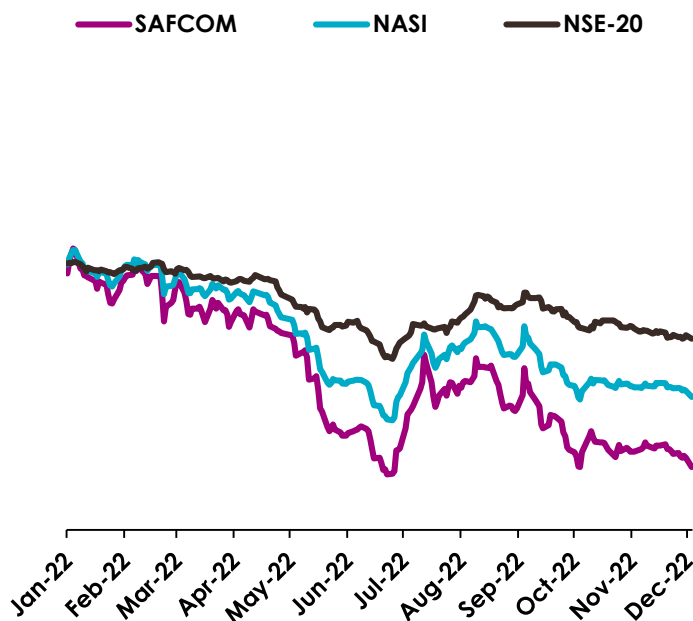
Rating: BUY	Current Price: KES 24.85	Target Price: KES 32.18
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Share Data

Bloomberg Ticker	SAFCOM KN
Reuters ticker	SCOM.NR
Current Price (KES)	24.85
Target Price (KES)	32.18
Upside	29%
Rating	BUY
52WK High (KES)	45.25
52WK Low (KES)	23.00
Market Cap (Bn)	947.66
Shares outstanding (Bn)	40.07
Dividend yield (%)	0.00
EPS	1.74
P/E	13.59

Source: Company financials, NCBA IB Research, NSE

Share price performance



In this update, we maintain our **BUY** recommendation with a revised target price of **KES 32.18**, implying a 30% upside relative to the volume weighted average price of KES 24.85 recorded on 19th December 2022 exclusive of dividend yield. Our publication of December 2021 had a SELL recommendation with a target price of KES 34.22.

EPS FY23F		Target price		Rating	
Previous	Current	Previous	Current	Previous	Current
2.0	2.2	KES 34.22	KES 32.15	SELL	BUY

Source: NCBA IB Research Estimates

Investment Case

Strong fundamentals: We believe Safaricom will continue to deliver stable growth. As a result, we maintain a cautiously optimistic stance on the diversification venture in Ethiopia.

Dividend: We expect Safaricom to declared a dividend for the period FY23 following steady revenue growth and additional income driven from Ethiopia.

Share price performance

Safaricom's performance at the Nairobi Securities Exchange has been depressed, down 38% year-to-date compared to the wider index's 26% decline attributable to the sustained sell-off in the equities market. Safaricom accounts for approximately 50% of the market, based on market capitalization.

The share price has suffered from a global downturn in investor sentiment, driven by concerns over rising interest rates and amplified by deteriorating macroeconomic conditions.

	YTD	H/H	Q/Q	M/M
SAFCOM	(38.0%)	(5.2%)	(5.2%)	(2.6%)
NASI	(25.5%)	(0.04%)	(3.1%)	(1.6%)
NSE-20	(14.5%)	(1.48%)	(4.7%)	(2.5%)

Source: NSE, NCBA IB Research

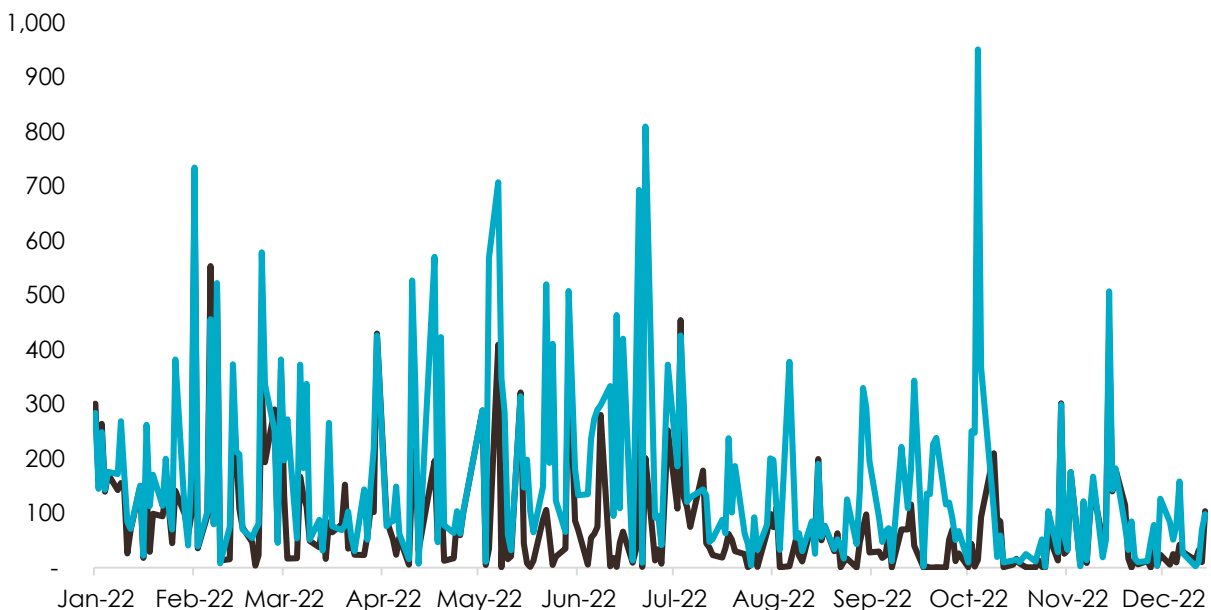
Foreign participation

The equities market has remained clouded by negative risk sentiment which has seen a sustained sell-off by foreigners.

Safaricom has witnessed sustained foreign investment outflow driven by concerns about rising inflation and interest rates coupled with geopolitical risks following Russia's full invasion of Ukraine.

Safaricom counter foreign participation

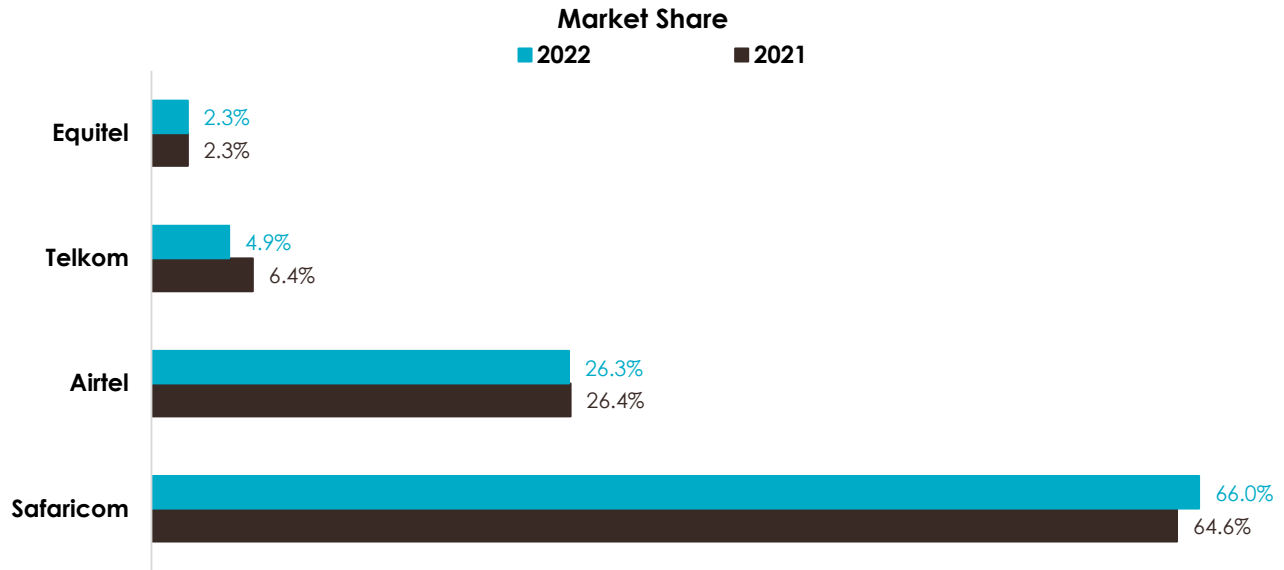
— Foreign buys — Foreign sells



Source: NSE, NCBA IB Research

Market dominance

Safaricom has continued to be the market leader with a 66% market share.



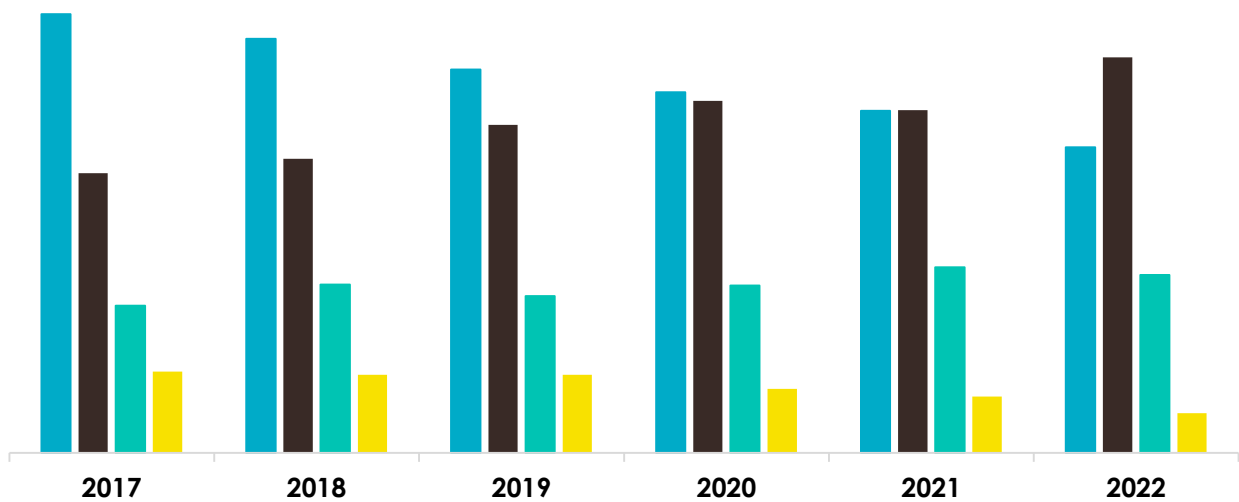
Source: CA, NCBA IB Research

Revenue mix:

Safaricom's revenue mix has shifted with M- pesa accounting for approximately 37%, FY22.

Product revenue mix

■ Voice ■ M-Pesa ■ Mobile data ■ SMS



Source: Company financials, NCBA IB Research

Regional diversification in Ethiopia

Safaricom commenced operations in Ethiopia in August 2022. Revenue in 1H23 included KES 9.1Mn from Ethiopia, generated in the first one month since the beginning of network roll out plan.

This diversification strategy could help Safaricom achieve revenue expansion above consensus and also entrench the company's presence in the region.

The company is however focused on driving adoption, targeting over 25% coverage in the first year of its rollout. This implies that a major revenue boost may not be actualized until 2024.

Co-operation with the existing telecom provider, i.e., Ethio telco, is necessary so as to drive service adoption. The two entities will share infrastructure in the short term. Safaricom expects to set up its own infrastructure within three years pending regulatory approvals. Safaricom and Ethio Telecom have infrastructure sharing and interconnection agreements in place. Under the agreement, whose financial terms are yet to be publicly revealed, Ethio Telecom provides Safaricom with access to cell towers, communication masts, and other active elements such as network roaming.

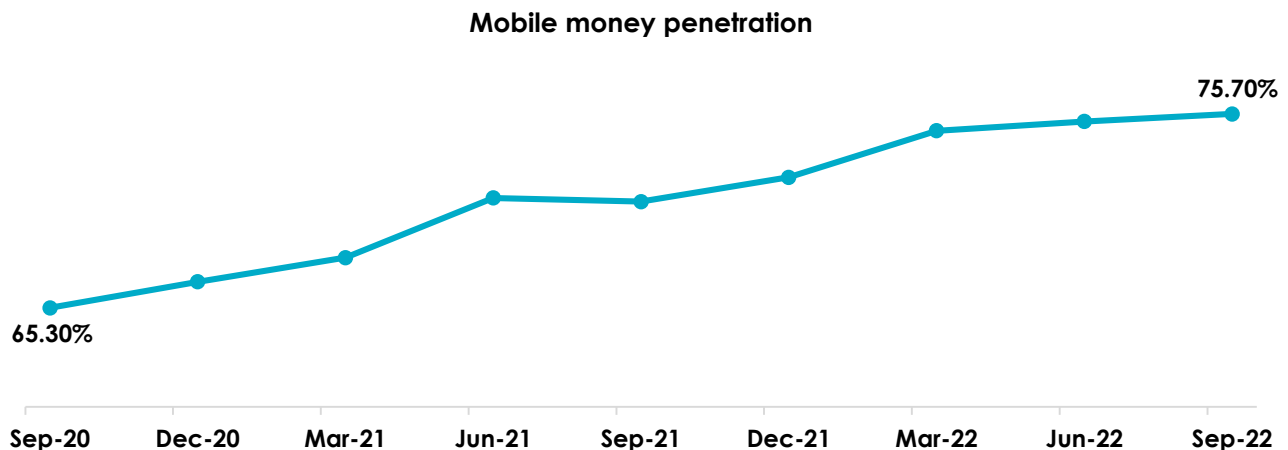
The underlying driver in Ethiopia remains the populous demography of 118Mn people, offering vast opportunities of growth. A minority of Ethiopians use mobile data and mobile money services, and Safaricom is well placed to benefit as this changes. Spending power is however limited and unevenly spread.

A potential source of revenue growth which could boost confidence, is M-pesa. Safaricom was licensed to offer mobile-money services in Ethiopia in October 2022. Its rival, Ethio Telecom, launched its mobile money services in May 2021.

Replicating success in Ethiopia comes with its challenges, including regulators, concerns over the capital outlay and the performance of the Ethiopian economy. We remain cognizant of the political risk in Ethiopia and its potential impact on Safaricom.

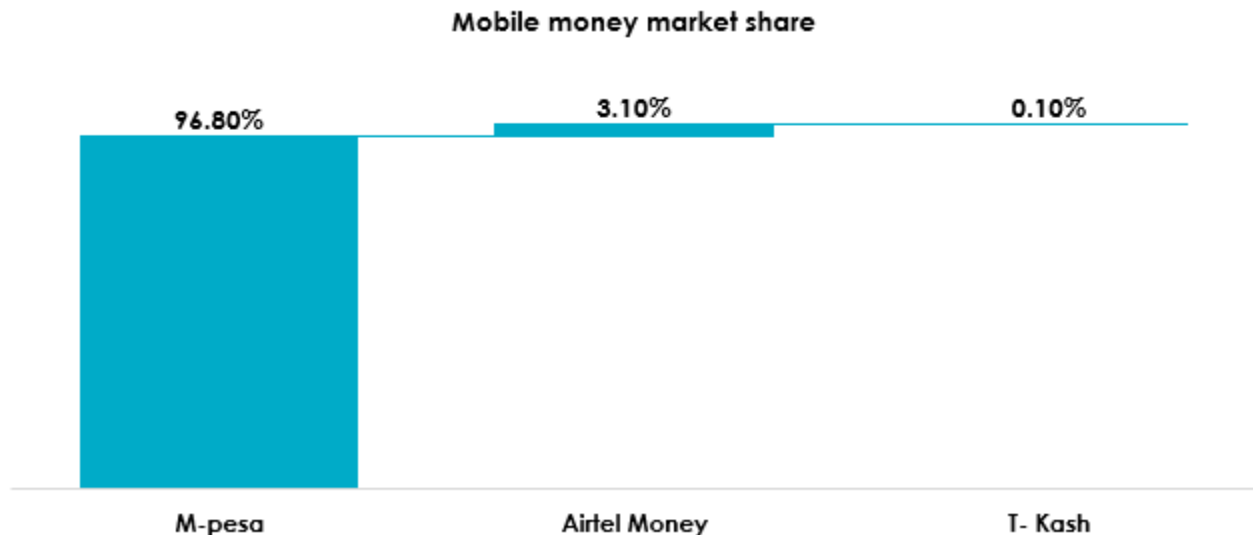
Robust growth in mobile money

Kenya is the global leader in mobile money with a penetration level of 75 percent which represents 37.4Mn mobile money subscribers.



Source: CA, NCBA IB Research

Mpesa boasts of 31.17Mn one-month active customers. A third of Safaricom's revenue comes from M-pesa and the service is deeply connected to its mobile business.

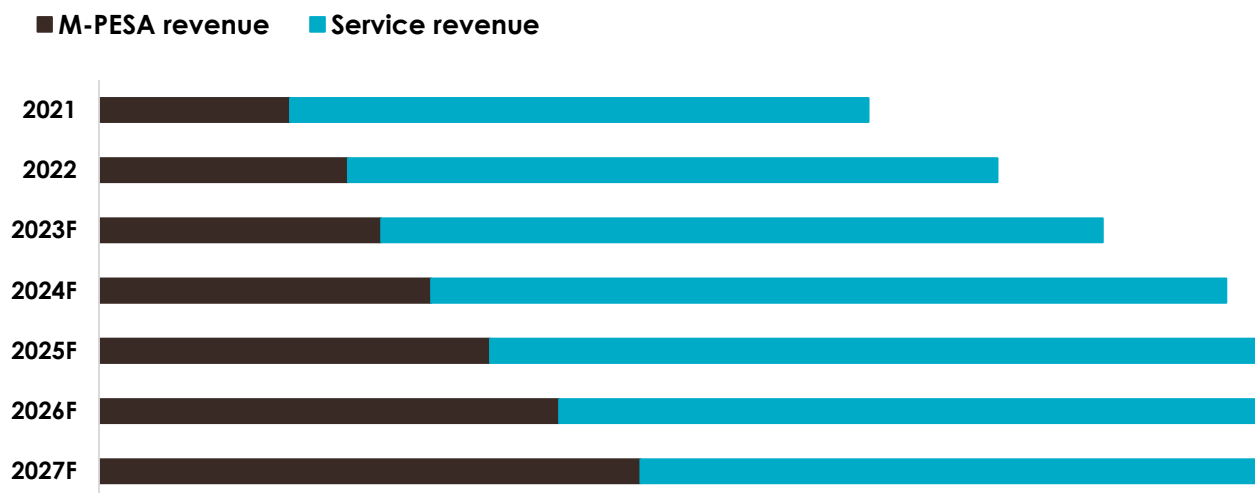


Source: CA, NCBA IB Research

Value from M-pesa is driven from more than person-to-person transfers, having added savings, loans, in-store purchases through Paybill and Till services, bill payments, insurance services and international transfers to its list of transactions.

We are bullish on Safaricom's M-pesa revenue growth in the next five years (CAGR of 38%) on the back of growing number of customers as depicted in 1H23 in which Mpesa customers grew by 10.2% y/y to 31.17Mn subscribers.

M-PESA revenue grew by 8.7% to KShs 56.86Bn supported by increased usage and growth of chargeable transactions per customer growing 16.3% y/y. We expect M-pesa contribution to service revenue to increase to approximately 41.5% from 38.31% realized in 2022.



Source: Company financials, NCBA IB Research

The Central Bank of Kenya announced the reintroduction of transaction charges between mobile money wallets and bank accounts, which had been waived in March 2020. The reintroduction, which is effective January 2023, comes with a revised guiding framework for setting tariffs.

We expect increased revenue from the transaction charges to drive M-pesa revenue growth in 2HY23 and subsequent years.

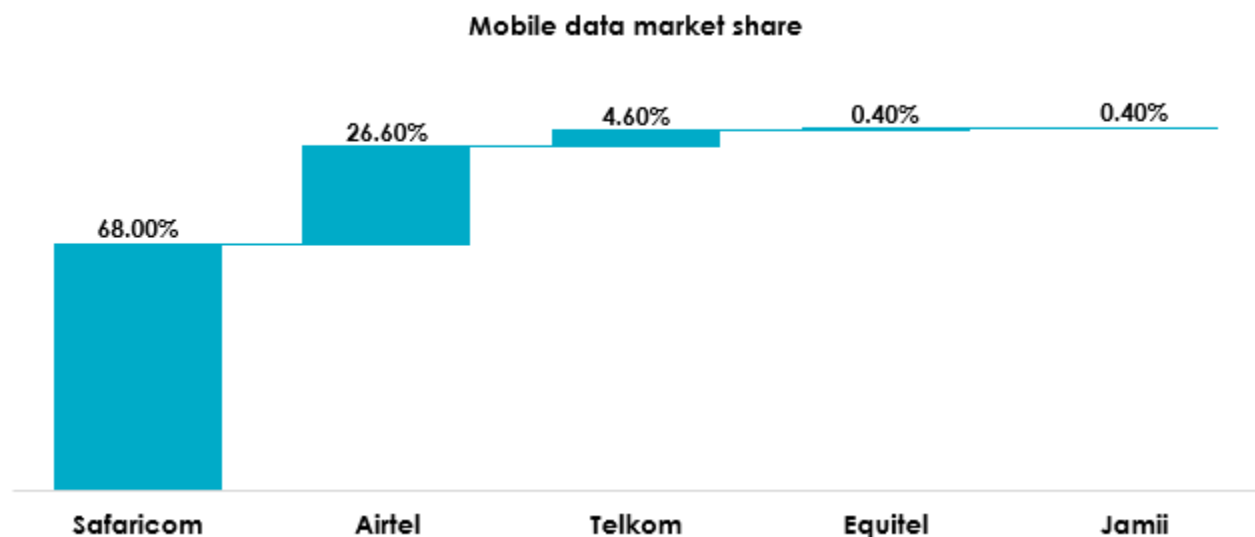
We believe the number of transactions will only be slightly dented given the price inelasticity of mobile money, which has since become a necessity.

The focus on mobile money as a growth engine is justified, Mpesa will keep delivering double digit growth to meet demand that may only be negligibly impacted by inflationary pressures.

Mobile data expansion

Mobile data revenue, one of Safaricom's two core products, accounts for approximately 20% of service revenue and has been growing exponentially. According to Communications Authority of Kenya (CA), smart phones penetration rate in Kenya is currently at 54.3% which offers opportunities for telecom operators to further increase data.

Mobile data revenue grew by 11.3% y/y to KES 26.30Bn in HY23. This was on the back of a growing trend of mobile data subscriptions coupled with the wide variety of data packages offered as Safaricom seeks to deep its dominance. It's biggest competitor in this space has been Airtel.



Source: CA statistics as at June 2021, NCBA IB Research

The launch of 5G and continuing expansion of 4G networks buoyed mobile-data revenue in 1HY23. The bulk of data traffic is already on 4G, given its larger capacity and greater efficiency. While 5G has been launched, it is set to remain niche for the next few years as its still on trial stages.

Handset revenue grew by 34% attributable to 'Lipa mdogo mdogo' initiative which is a Safaricom promotion driving smart phone penetration through financing for a smartphone at just KES 20 (\$0.17) a day. The uptake of these devices could bolster mobile data revenue growth.

We expect a marginal rise in 30-day active mobile data customers to 26Mn subscribers and project mobile data revenues at KES 60Bn.

Elevated costs

Direct costs grew by 5.1% while operating costs increased by 32.2% on the back of infrastructural expenditure. The latter was largely driven by set-up of operations in Ethiopia.

Inflation escalated to 9.5% in November 2022 amid soaring commodity and fuel prices. Safaricom has a lower leverage rate than its global peers and this cushioned it, leaving flexibility to invest in growth.

We expect costs to remain elevated as Safaricom injects more capital into the Ethiopia venture. Moreover, inflation in 2023 is expected to be only slightly higher than in recent history and could drop to the target band (2.5%- 7.5%) in the following years. In the short run, high inflation translates to higher cost of inputs needed for infrastructural development.

Looking ahead, debt levels have increased to a long term debt to equity ratio of 33.11% and a gearing ratio of 23.3%. This follows the acquisition of KES 44.91Bn debt from the International Finance Corporation (IFC).

Safaricom's exposure to interest rate risk and foreign exchange risk has slightly increased. The proportion of debt in KES should however reduce foreign exchange risk exposure.

VALUATION

Following the HY2023 earnings release, and given some of the key business announcements by the company since our last publication, we have reviewed our forecasts and subsequently our valuation of the stock.

From our estimates and assumptions, we see a significant upside potential and maintain our **BUY** recommendation with a target price of **KES 32.18**.

The target price implies an upside of 30% to the current trading price of KES 24.85 as of 19th December 2022.

We have used four valuation methodologies to arrive at our fair value estimate:

1. Discounted Cash flow
2. EV/EBITDA
3. Price to Book Valuation
4. Price to earnings Valuation

Equal weighting (25%) was given to each of the four valuation methods to arrive at our fair value.

Valuation Methodology	Implied Price	Weighting	Weighted Value
DCF Approach	41.57	25%	10.39
EV/ EBITDA Approach	30.78	25%	7.69
P/B Approach	31.28	25%	7.82
P/E Approach	25.09	25%	6.27
Fair Value		100%	32.18
Current Price (at 19.12.2022)			24.85
Upside/(Downside)			29%

Source: NCBA IB Research estimates

Relative Valuation: Peers in Emerging markets

Company	Location	Ticker	Mkt Cap (KES Bn)	EV/EBITDA	P/E	P/BV
Airtel Africa PLC	Africa	AAF LN	690.71	3.4254	7.4868	1.6258
Airtel Malawi PLC	Africa	AIRTEL MW	73.17	3.5247	--	45.0934
Asiacell Communications	M. East	TASC IQ	189.91	6.9745	--	1.5572
Emirates Telecommunications	Africa	EAND UH	7,349.48	9.0507	21.5227	5.3466
Helios Towers PLC	Africa	HTWS LN	186.76	7.2504	--	30.0948
IHS Holding Ltd	Africa	IHS US	291.19	5.1655	18.75	1.8515
Itissalat Al-Maghrib	M. East	IAM MC	1,087.48	6.5331	14.8584	8.3716
Kuwait Telecommunications	M. East	STC KK	228.40	6.0575	14.225	2.4542
Mobile Telecommunications	Africa	ZAIN KK	1,010.44	6.4153	10.9623	2.0903
MTN Group Ltd	Africa	MTN SJ	1,779.57	3.4671	9.9699	2.1632
MTN Uganda Ltd	Africa	MTNU UG	134.28	3.7527	7.6174	4.3598
National Mobile Telco	Africa	OOREDOO KK	235.87	3.1301	29.275	1.1048
Safaricom PLC	Africa	SAFCOM KN	951.55	7.1424	13.946	6.6159
Telecom Egypt Co	Africa	ETEL EY	213.75	3.6424	5.0373	0.9195
Telkom SA SOC Ltd	Africa	TKG SJ	122.12	3.1037	8.9484	0.47
Vodacom Group Ltd	Africa	VOD SJ	1,632.47	6.0651	11.786	2.5354
Vodacom Tanzania Ltd	Africa	VODA TZ	91.20	6.7153	--	1.3742
Average			956.96	5.377	13.41	6.94

Source: Bloomberg, NCBA IB Research estimates

Historical Financial performance (KES Mn)

	2017	2018	2019	2020	2021	2022
Voice revenue Actuals	86,374	88,639	87,684	86,530	82,552	83,212
Messaging revenue Actuals	15,995	16,751	17,865	15,404	13,602	10,877
Mobile data revenue Actuals	28,988	36,040	35,868	40,158	44,793	48,441
M-PESA revenue Actuals	55,084	62,907	74,990	84,438	82,647	107,692
Mobile incoming revenue Actuals	6,917	7,063	8,525	8,482	9,470	9,848
Other mobile service revenue Actuals	5,509	6,461	6,734	7,237	7,779	9,795
Fixed line and wholesale transit revenue Actuals	5,242	6,673	8,101	8,967	9,507	11,243
Service revenue	204,109	224,535	239,767	251,214	250,352	281,107
Handset revenue and other revenue Actuals	8,700	8,980	9,448	10,488	12,317	16,527
Construction revenue Actuals	76	202	603	584	838	-
Other income Actuals	2,626	511	464	270	521	443
Revenue from other sources	11,402	9,693	10,516	11,342	13,675	16,971
Total Revenue Actuals	215,511	234,228	250,283	262,556	264,027	298,078
Direct costs Actuals	(66,858)	(70,757)	(72,389)	(75,285)	(80,853)	(91,468)
Other expenses Actuals	(44,928)	(50,636)	(53,590)	(47,560)	(46,035)	(55,187)
Expected credit losses on financial assets Actuals	-	-	-	(1,670)	(3,010)	(2,361)
Cost Of sales Actuals	(111,786)	(121,393)	(125,979)	(124,514)	(129,897)	(149,016)
EBITDA Actuals	103,725	112,835	124,304	138,042	134,129	149,062
Depreciation of property, plant and equipment Actuals	(31,546)	(31,908)	(33,660)	(31,965)	(32,625)	(34,145)
Amortization – Indefeasible Rights of Use (IRUs) Actuals	(345)	(301)	(301)	(301)	(407)	(281)
Amortization - intangible assets Actuals	(1,343)	(1,359)	(1,370)	(1,359)	(1,629)	(1,850)
Amortisation – Right-of-use (RoU) assets Actuals	-	-	-	(2,923)	(3,305)	(3,657)
Total Operating Expenses Actuals	(33,234)	(33,568)	(35,331)	(36,548)	(37,964)	(39,933)
Operating Profit Actuals	70,491	79,267	88,973	101,494	96,165	109,129
Finance income Actuals	1,723	1,830	2,760	3,519	2,198	2,413
Finance costs Actuals	(1,484)	(1,197)	(520)	(2,597)	(4,221)	(8,853)
Net Finance costs Actuals	239	633	2,240	922	(2,022)	(6,439)
Share of profit/ (loss) of associate Actuals	19	10	5	61	(193)	(280)
Share of (loss)/profit of joint venture Actuals	-	-	-	3,296	(314)	(196)
Total Share of (loss)/profit	19	10	5	3,357	(507)	(476)
Profit before income tax Actuals	70,749	79,910	91,218	105,773	93,636	102,213
Income tax (expense)/ credit Actuals	(22,188)	(24,620)	(28,727)	(32,115)	(24,959)	(34,717)
Total Net Profit After Tax	48,561	55,290	62,491	73,658	68,676	67,496
Number of shares outstanding				40,065	40,065	40,065
EPS				1.84	1.71	1.68

Source: NCBA IB Research Estimates, Company Financials

Financial forecasts (KES Mn)

	2023	2024	2025	2026	2027
Voice revenue	86,425	88,776	91,190	93,671	96,219
Messaging revenue	10,115	9,407	8,749	8,136	7,567
Mobile data revenue	58,931	63,056	67,470	72,192	77,246
M-PESA revenue	122,062	143,667	169,096	199,026	234,253
Mobile incoming revenue	10,597	11,402	12,269	13,201	14,204
Other mobile service revenue	11,018	12,393	13,939	15,679	17,636
Fixed line and wholesale transit revenue	13,123	15,319	17,882	20,873	24,365
Service revenue	312,270	344,019	380,594	422,779	471,490
Handset revenue and other revenue	18,876	21,558	24,621	28,120	32,116
Construction revenue	-	-	-	-	-
Other income	488	536	590	649	714
Revenue from other sources	19,363	22,094	25,212	28,769	32,830
Total Revenue	331,634	366,113	405,806	451,548	504,320
Direct costs	(106,123)	(117,156)	(129,858)	(144,495)	(161,382)
Other expenses	(59,694)	(65,900)	(73,045)	(81,279)	(90,778)
Expected credit losses on financial assets	(1,426)	(1,574)	(1,745)	(1,942)	(2,169)
Cost Of sales Actuals	(167,243)	(184,631)	(204,648)	(227,716)	(254,329)
EBITDA Actuals	164,391	181,482	201,158	223,832	249,991
Depreciation of property, plant and equipment	(37,248)	(49,685)	(63,414)	(78,631)	(95,565)
Amortization – Indefeasible Rights of Use (IRUs)	(253)	(253)	(253)	(253)	(253)
Amortization - intangible assets	(4,807)	(4,944)	(5,096)	(5,266)	(5,455)
Amortisation – Right-of-use (RoU) assets	(3,660)	(3,660)	(3,660)	(3,660)	(3,660)
Total Operating Expenses	(45,968)	(58,541)	(72,423)	(87,810)	(104,932)
Operating Profit	118,423	122,941	128,735	136,022	145,059
Finance income	3,017	3,318	3,650	4,015	4,417
Finance costs	(3,571)	(3,749)	(3,937)	(4,133)	(4,340)
Net Finance costs	(554)	(431)	(286)	(118)	77
Share of profit/ (loss) of associate	(280)	(280)	(280)	(280)	(280)
Share of (loss)/profit of joint venture	(196)	(196)	(196)	(196)	(196)
Total Share of (loss)/profit	(476)	(476)	(476)	(476)	(476)
Profit before income tax	117,393	122,034	127,973	135,428	144,660
Income tax (expense)/ credit	(36,127)	(37,556)	(39,383)	(41,677)	(44,519)
Total Net Profit After Tax	81,266	84,479	88,590	93,751	100,142

Source: Company financials, NCBA IB Research Estimates

About NCBA Investment Bank

NCBA Investment Bank is a subsidiary of NCBA Group. The services offered by the brokerage department include equities trading for listed securities, fixed income trading for both corporate and government bonds, Over the Counter (OTC) equity transactions as well as execution of equities transactions across the East African countries. Additionally, NCBA Investment Bank backs these activities with solid advice from the research team to enable investors meet their return objectives. NCBA Investment Bank deploys simple and convenient client driven technologies, robust risk management, highly competent and experienced staff and has the backing of robust research capabilities to differentiate itself from other players in the market.

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Certification

The following analyst(s) who prepared this research report: Victoria Mututu hereby certifies(y) that: (i) all of the views and opinions expressed in this research report accurately reflect the research analyst's(s') personal views about the subject investment(s) and companies (y) and (ii) no part of the analyst's(s') compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed by the analyst(s) in this research report.

Rating Definitions

BUY – Total expected 12-month return (incl. dividends) greater than 20%
ACCUMULATE - Total expected 12-month return (incl. dividends) between 10% - 20%
HOLD – Total expected 12-month return (incl. dividends) between 0% -10%
SELL – Total expected 12-month return (incl. dividends) less than 0%

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