

SAFARICOM | POST HY24 COMPANY UPDATE

Safaricom released its HY 2024 financial results posting a largely impressive set of results. The return on Capital Employed (ROCE) declined to 55.3% from 56.6% y/y. Earnings per share rose to **KES 0.90** from KES 0.80 in the previous financial year.

Key Highlights:

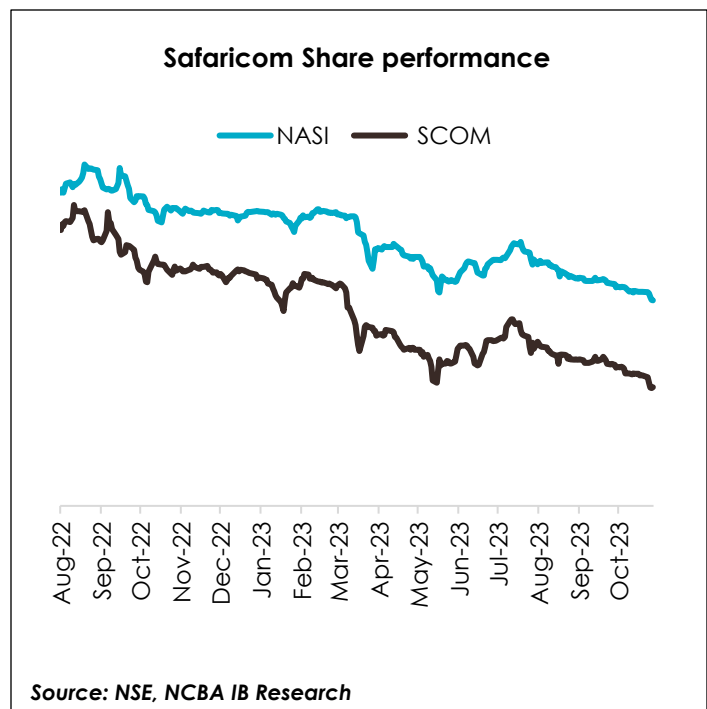
Profitability: Net Income grew 10.9% y/y to KES 41.6Bn supported by growth in M-PESA and mobile data revenue in the period. Profit after tax however declined by 10.1% largely attributable to 21.9% increase in operating expenses to KES 37.7Bn.

Mpesa revenue: grew by 16.5% to KES 66.23Bn supported by increased personal usage and growth of chargeable transactions per one-month active customers. Financial services revenue however, registered a 19% decline y/y to close at KES 4Bn primarily driven by a decline in revenue attributable to decline in Fuliza.

Mobile data: Mobile data revenue increased to KES 29.6Bn, a 12.5% increase as the firm continues to leverage on personalized offers through Customer Value Management (CVM) initiatives which support usage and growth. The telco continues to support customers in purchasing 4G-enabled devices through their affordable Lipa Mdogo Mdogo (LMM). LMM has enabled over 1Mn customers to enjoy more features at their convenience. Mobile data currently accounts for 18.8% of Service Revenue.

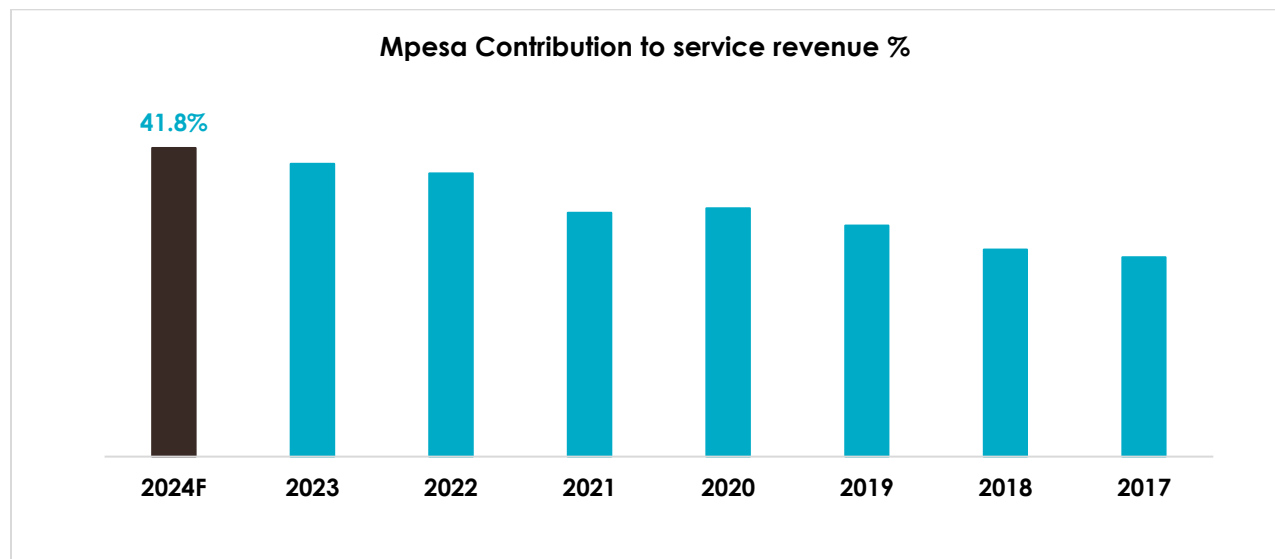
Voice and messaging revenue declined by 3.0% to KES 38.69Bn in line with global trends. The telco continues to leverage on Customer Value Management (CVM) initiatives to provide better segmented and personalized offers and customers' propositions. In addition, the telco been optimizing our pricing over the years to ensure that we continue driving affordability and usage. Voice and messaging revenue are now 28.3% of service revenue.

Share Data	Safaricom Group Plc
Ticker	SAFCOM KN
RECOMMENDATION	BUY
Current Price (KES)	13.50
Target Price (KES)	23.40
Upside	73.3%
52WK High (KES)	29.00
52WK Low (KES)	11.50
No. of shares issued (Bn)	40.07
Market Cap (KES Bn)	498.84
Free Float	40.0%
EPS (HY'24)	KES 0.9
P/E	7.5x
P/B	2.5x
Current Price = VWAP as at 10th November 2023	



KEY THEMES:
M-PESA was the Key driver of growth

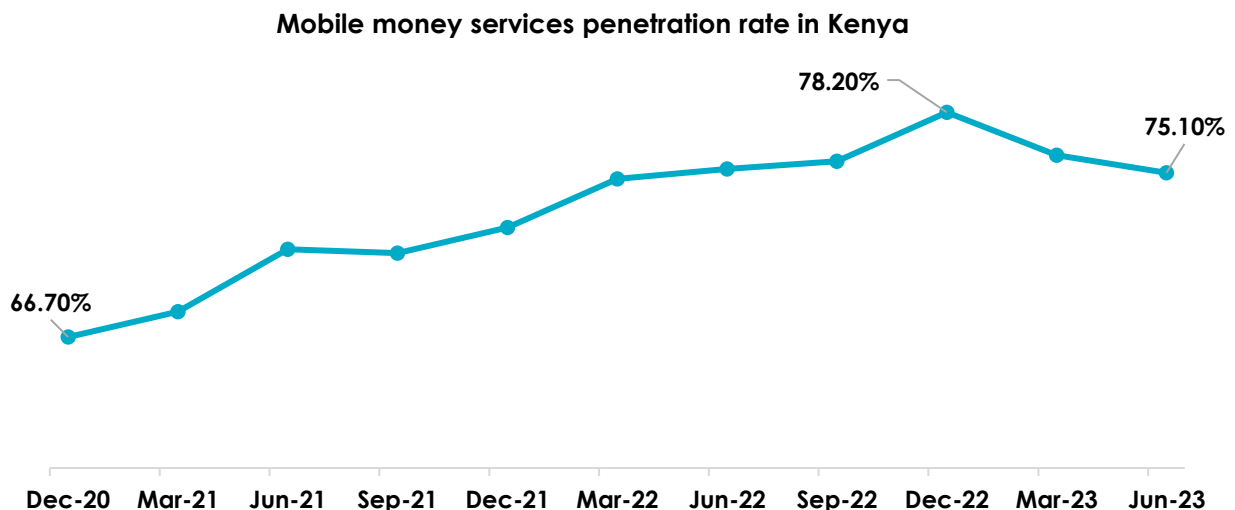
Mpesa revenue grew by 16.5% to KES 66.23Bn supported by increased usage and growth of chargeable transactions per one-month active customers by 28.9%. During the period, one-month active M-PESA customers grew by 3.1% to 32.13Mn while Lipa Na M-PESA active merchants grew 22.3% to 658.35k.



*2024F- Forecast

Source: Company financials, NCBAIB Research

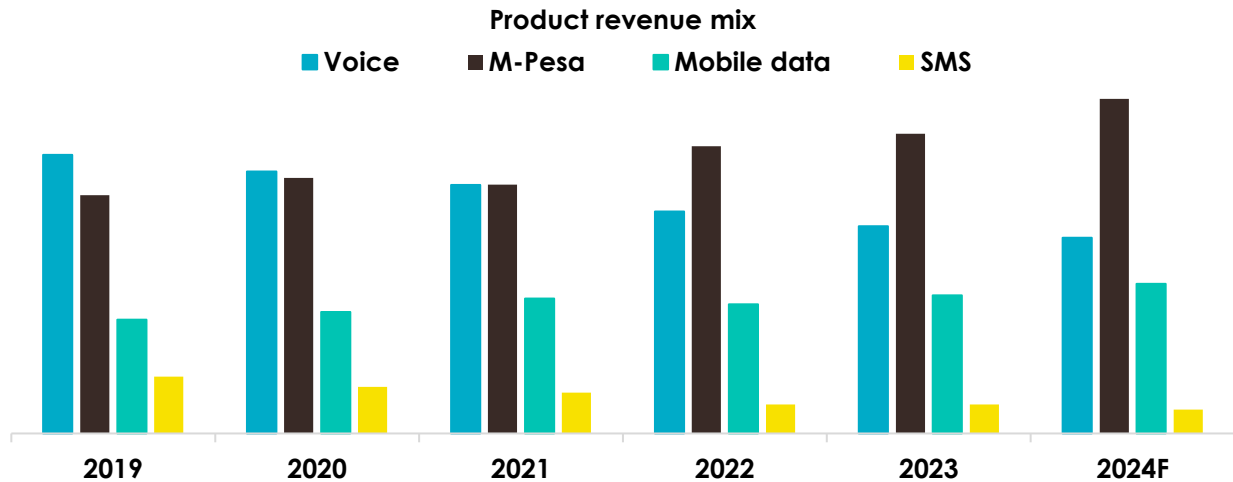
M-PESA now accounts for 42.1% of service revenue, further complementing connectivity revenues. We estimate M-pesa contribution at the end of FY24 will stand at approximately 42% of service revenue. We have however witnessed some volatility in the mobile money penetration in the country in 2023 with a decline to 75% from 78% recorded in December 2022 which might present a risk to our M-pesa performance guidance.



Source: CA, NCBA IB Research

Evolution of product revenue: M-pesa and Mobile data share of revenue increases

Mobile data and Mpesa contribution to revenue rose to 19% and 42% from 39% and 18%, respectively. Mobile data recorded double digit growth fueled by enhanced monetization and value propositions.

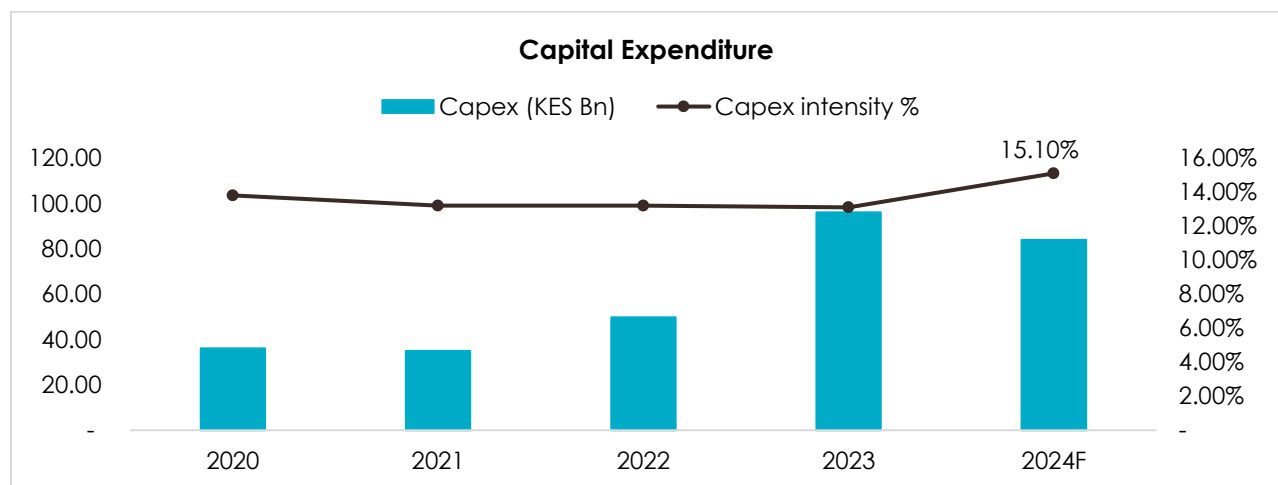


Source: Company financials, NCBAIB Research

Fixed enterprise and FTTH contribution grew to 4.7% from 3.65 in the previous period driven by improved penetration. Fixed service and Wholesale transit revenue rose by 9.1% to KES 7.37Bn supported by growth in consumer revenue which rose 28.8% to KES 3.01Bn which offset the 1.4% decline in Enterprise revenue to KES 4.36Bn. FTTH penetration rose to 61.4% with homes connected growing 41.5% to 320.27k while Fixed Enterprise customers grew by 0.4% to 54.74k.

Capital expenditure - weighs down on the business

Capex saw an increase to 93.1% to KES 96.1Bn driven by accelerated spending on investment in the new growth region of Ethiopia. Capex in Ethiopia was undertaken to support site, infrastructure costs to increase coverage in the growing market.



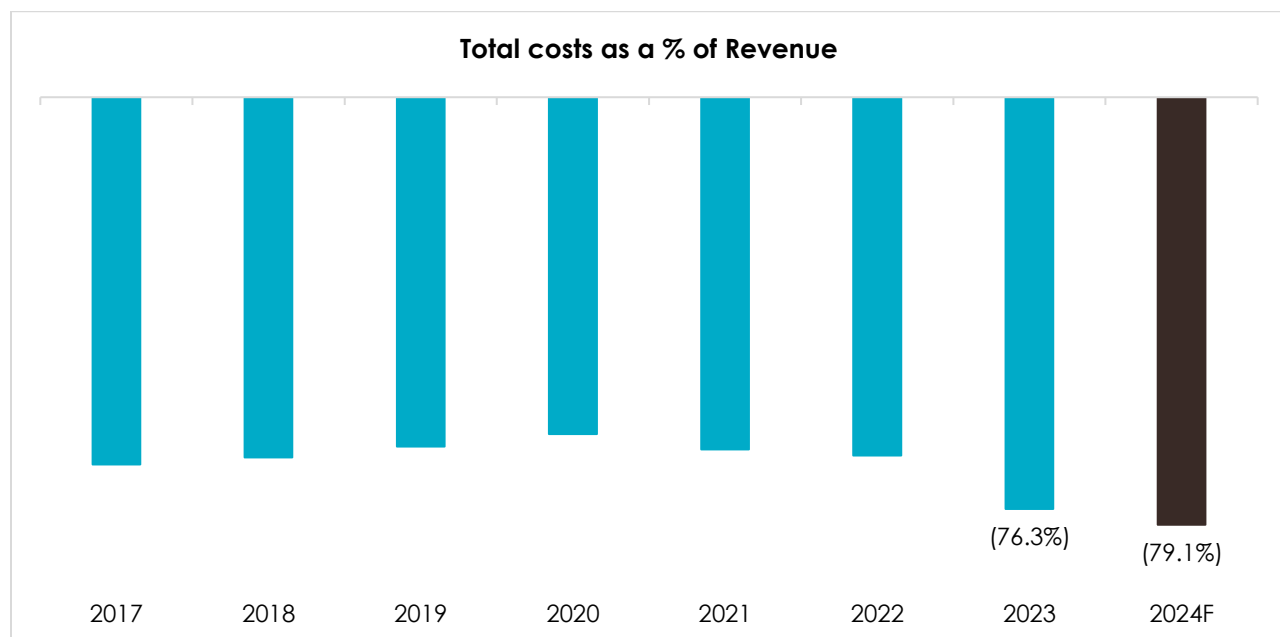
Source: Company financials, NCBAIB Research

Surging Costs- Navigating a challenging operating environment

Direct cost declined by 5.2% to KES 44.4Bn driven by a reduction in Handset costs and other direct costs. However, operating costs grew by 21.9% to KES 37.7Bn driven by a 41.2% increase in network operating costs to KES 12Bn.

Finance costs also shot up to KES 7.1Bn from KES 2.9Bn. We view this as an effect of the increase in debt servicing costs associated with the KES15Bn debt acquired during the period.

Consequently, long term borrowings rose by 40.8% to KES 59.2Bn and provision for expected credit loss (ECL) on receivables also grew by 74% to KES 2.8Bn.



**Total costs= Direct costs+ Depreciation and Amortization+ Finance costs*

Source: Company financials, NCBAIB Research

Safaricom's exposure to interest rate risk and foreign exchange risk has increased with the increase in debt.

The Kenya shilling has depreciated by 22.9% against the greenback in 2023 with the expectation of a further decline. We expect the shilling to continue depreciating against major currencies owing to the widening interest rate differentials, reserve currency preference due to geopolitical risks and elevated import costs.

Interest rates have maintained an upward adjustment by an average of 500bps across the yield curve. We expect interest rates to remain elevated in line with inflation expectations, tighter monetary policy, and elevated sovereign appetite for domestic borrowing.

Financial performance summary

Safaricom PLC	Key Metrics Y/Y
Service Revenue	Up 9.9% to KES 159.1Bn
Mpesa Revenue	Up 16.5% to KES 66.2Bn
Voice revenue	Down 1.9% to KES 39.1Bn
Mobile data revenue	Up 17.7% to KES 30.9Bn
Fixed Service and wholesale transit revenue	Up 9.1% to KES 7.37Bn
Messaging Revenue	Up 6% to KES 5.75Bn
Capital Expenditure	Up 11.7% to KES 41.9Bn
PBT	Down 2.7% to KES 46.9Bn
PAT	Down 10.1% to KES 27.2Bn
EPS	Up 12.5% to KES 0.90

Safaricom PLC	Key Ratios Y/Y
EBITDA Margin	Up to 55.9% from 52.2%
EBIT Margin	Up to 41.5% from 38.1%
Net debt to EBITDA	Maintained at 0.41x
ROCE	Down to 55.3% from 56.6%
ROE	Down to 23.7% from 30.5%
Market Price as at 10th November 2023	KES 13.50
P/E	7.5x
P/B	2.5x

Source: Company financials, NCBA IB Research

Share price performance

Safaricom's performance at the Nairobi Securities Exchange has been depressed, down 44% year-to-date compared to the wider index's 30% 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.

As at 10 th November 2023	Year to Date (%)
SAFCOM	(43.9%)
NASI	(30.2%)
NSE-20	(15.2%)

Source: NSE, NCBA IB Research

Outlook

We expect increased revenue from Safaricom Ethiopia, M-pesa, and mobile data revenue streams. Safaricom operations in Ethiopia could help achieve revenue expansion above consensus and entrench the company's presence in the region. However, we maintain a cautiously optimistic stance on this diversification venture.

- 1. Revenue Diversification:** We expect increased revenue from Safaricom Ethiopia, M-Pesa, and mobile data revenue streams. The telco's digital transformations and building technological capacities in areas of AI, Big data, Analytics and giving more access to 4G Devices along with scaling of Ethiopia operations which are being driven by accelerated network roll outs and Mpesa.
- 2. Scale Ethiopia Operations:** The Telco giant launched its Ethiopia network last year, betting that the populous nation will power growth after about five years of investment. The business is set to breakeven in 4-years. Aggressive network expansion, infrastructure costs will see operation costs tick upwards. Moreover, the launch of Mpesa in Ethiopia will come along with infrastructure and rolling out costs. M-PESA in Ethiopia is gaining quick traction in the market with over 1 million registered customers within the first month of commercial launch.
- 3. Public Sector Digitization:** The telco works closely with the public sector and relevant industry stakeholders to provide connectivity, infrastructure development such as cloud and fiber, financial technology, and affordable smartphones to Kenyans. In Agriculture, it digitized the roll out of the revolutionary fertilizer subsidy program to over 3.3 million farmers in 41 counties across the country. Under the Financial Inclusion programs, over 22 million Kenyans have benefited from the Hustler and Women Enterprise Fund through which the telco facilitates access to affordable credit. In Health, it is partnering with the National Government to support County Governments in strengthening Community Health Services through the Afya Bora Mashinani program.
- 4. New Growth Areas Acceleration:** In partnership with TeleOne and Jamii Telkom, the telco has launched a smartphone device assembly in Kenya, through the East Africa Device Assembly Kenya to accelerate the access & penetration of affordable 4G devices in the country. The Telco's setting of foot into Fiber, OT, ICT, Insurance and wealth management will help deliver strategy ambition.

Safaricom PLC	FY24 Estimates
EBITDA	KES 140Bn - KES 150Bn
EBIT	KES 75Bn – KES 81Bn
Capex	KES 82Bn – KES 90Bn
EBITDA Margin	50% - 55%
EBIT Margin	35% -40%

Source: Company financials, NCBA IB Research

Valuation

Following the HY2024 earnings release, and considering material information provided on Safaricom Ethiopia business since our last publication, we 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 23.40**. The target price implies an upside of 73% to the current trading price of KES 13.50 as of 10th November 2023.

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	22.88	25%	5.72
EV/ EBITDA Approach	20.38	25%	5.09
P/B Approach	21.13	25%	5.28
P/E Approach	29.20	25%	7.30
Fair Value		100%	23.40
Current Price (at 10th November 2023)			13.50
Upside/(Downside)			73.3%

Source; Company financials, NCBA IB Research

Investment recommendation:

Going forward We believe that the business is well positioned to unlock Kenya & Ethiopia's economic growth, solve customer and societal issues as well as deepen digital and financial inclusion in both countries.

We expect Safaricom Plc to deliver long-term profitability based on its focus on digital transformation and strong customer base. At the current market price, the stock presents a good entry position for long-term investors to earn capital gains and an attractive dividend yield. From our estimates and assumptions, we believe the stock is undervalued and maintain our BUY recommendation.

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