

Safaricom Plc is set to release FY-2021 earning results on Thursday May 13th, 2021. The company performance remains resilient with technology being one key contributors to economic performance especially in the Covid-19 Pandemic era. We recommend a HOLD on Safaricom at a valuation of KES 37.73 a downside of 7.5% compared to KES 40.80 at close of trade on Thursday May 7th, 2021. The market price level is propped by the anticipation of results release and entry into Ethiopia (we have not included entry into Ethiopia into our valuation). We foresee a 3.2% decline in service revenue and 1.2% drop in PBT. We forecast a KES 1.00 final dividend per share to give a total dividend of KES 1.45 which is a 3.6% increase compared to KES 1.40 DPS in FY-2020. Dividend yield of 3.7% to give an expected total return of -4.0% on our valuation price.

Price Remains King - Pricing remains a key factor in client capture and retention with most telecommunication companies offering promotion to their clients to manage loyalty. In a country where 75% of population is <35-year, pricing will continue to drive affordability especially creating young client loyalty due to their present low purchasing power.

The promotions target calls and data bundles. Home fiber promotion was retained on new entrants while mobile money products introduction will use pricing as test for informative plan. We fathom a 1.5% decline in voice revenues.

Online Shopping to Boost SMS Revenues – The pandemic has left clients shunning physical contact leading to digital transformation fronting the entry of gig-industry on home delivery. This has forced businesses to attract and to retain patrons through SMS marketing and reminders. Revival of betting industry will aid in supporting SMS revenue. This will reduce the erosion of SMS revenues to c.5%

4G and Smart Phone Drive on Data Revenues - The consumption of data continues to be championed by increase in 4G penetration enabled by cheap smart phone and internet penetration. 4G penetration stood at 10.84Mn subscription as end of December 2020. The drive has seen mobile data revenue increase by 5-year CARG of 22.4% while its share to revenue contribution jumping to 15.5% in 2020 vs 9.0% in 2015. Our view mobile data revenues will continue growing in double digit figures >10% for the next five years.

Fixed Data Boost on Digital Growth and Work from Home: According to Communication Authority Q2 2020-21 Statistical report, as of end 2020, Safaricom was the market leader in Fixed Data with 35.2% having increased by 46.9% compared to December 2019.

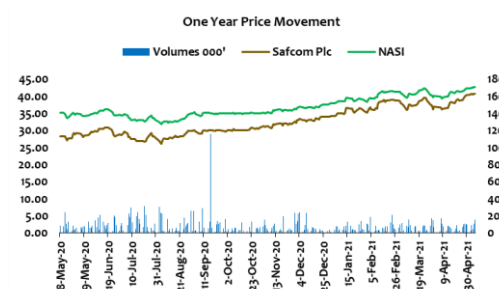
Fixed Data revenue has been on the rise growing by 5-year CARG of 23.4% with contribution to service revenues increasing to 3.4% from 1.9% in 2015.

Return of Mobile Money Charges – Reinstatement of mobile money transaction fees in Q4-21 will go a long way to elevate M-Pesa revenues from the 14.5% slide see in H1-21. We forecast the decline to ease to c.10% cushioned by the reopening of the economy in Q3-21. Safaricom remains dominant in the mobile money space.

With additional products in the commerce space and partnership with the government, the telco will continue to dominate the market to the near future.

Recommendation	HOLD
Current Price	40.80
Valuation Price	37.73
Upside/(Downside)	-7.5%
6-Month Average	36.86
12-Month Average	32.59
52 Week High/Low	40.80 - 26.15
No of Shares (Mn)	40,065.43
Market Cap (KES Bn)	1,634.67
Market Cap (USD Mn)	15.30
Free Float	25.0%
Dividend	1.45
Expected Div Yield	3.6%
Expected Total Return	-4.0%
Forward PE	22.47
EV/EBITDA (NTM)	12.27

Source: NSE, CBK, KSL



Source: NSE, KSL

Metric	Return Comparison		
	1-Year	6-Months	3-Months
Safcom	23.6%	41.2%	16.7%
NASI	16.6%	19.8%	11.1%

Source: NSE, KSL

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KINGDOM SECURITIES

Digital cash platforms will in one way or another be forced to plug into the M-Pesa platform for a full loop transaction.

Entry into Ethiopia: Safaricom was part the Global Partnership for Ethiopia (Vodafone, Vodacom, Safaricom, CDC Group and Sumitomo Corp) that submitted their proposal for the tender of one of the two telecommunication license to operate in Ethiopia.

In your paper, [Safaricom Plc Bid on Ethiopia Telecommunication License](#), we noted that only two telecommunication companies submitted their proposals by deadline date, thus we perceive Safaricom and its partners stand a good chance of winning one of the licenses.

Ethiopia remains a country of vast opportunities in the telecommunication sector. As of 2019 with a population of 112.08Mn with 78.8% living in the rural areas, the country had a GDP growth of 8.4%, 39.54Mn mobile subscription and a penetration of 35.3%.

If Safaricom gets the license, it put itself in a position to generate faster shareholders' value due to the new market. This will see share value growth and increase in par shared dividend.

Safaricom Forecast in Summary

Safaricom Plc (KES)							
Year End March 31 st	2019A	2020A	2021F	2022F	2023F	2024F	2025F
Sales (KES Mn)	250,283	262,556	255,038	277,212	299,136	324,563	354,007
Net Income (KES Mn)	62,491	73,658	72,756	79,189	90,567	100,175	111,796
Diluted EPS	1.56	1.84	1.82	1.98	2.26	2.50	2.79
PE (x)	26.2	22.2	22.5	20.6	18.0	16.3	14.6
EV/EBITDA	9.78	8.79	12.27	10.83	9.91	9.00	8.11
DPS	1.25	1.40	1.45	1.58	1.81	2.00	2.23
Net Dividend Yield	3.1%	3.4%	3.6%	3.9%	4.4%	4.9%	5.5%
BVPS	3.65	3.91	4.33	4.67	5.35	6.04	6.83
CFPS	2.49	2.75	2.72	2.93	3.15	3.44	3.78
FCFPS	2.20	2.58	2.26	2.72	2.89	3.26	3.59

Source: Safaricom Annual Report, KSL

Global Telecom Industry

International Monetary Fund (IMF) projects global economy shrunk by 3.3% in 2020 before recovering by 6.0% in 2021 then normalize to 4.4% in 2022. The recovery of the economy remains highly uncertain depending on the speed of vaccination.

The effects of the pandemic left a mark in the telecommunication sector with GSMA reporting that AT&T, Telefónica, Telecom Italia and a handful of others, were able to discern the negative financial impact directly associated with Covid-19, which has averaged 4% –8% of overall revenues. Locally, Safaricom reported a 4.8% half year decline in service revenue caused by 14.5% decline in M-Pesa revenues.

Safaricom Plc FY-2021 - Earning Updates

The consortium

Safaricom, Vodacom,
Vodafone, CDC Group,
Sumitomo Corp

Ethiopia Key Stats:

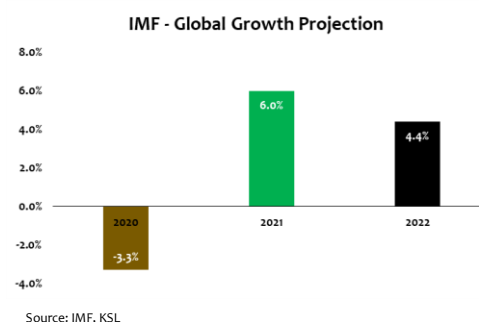
Population: **112.08Mn**

GDP Growth: **8.4%**

Inflation: **12.9%**

Mobile Subs: **39.54Mn**

Mobile Penetration: **35.3%**



FY-2021 - Earning Updates

Effects of Covid-19 on Telecom Revenues

- Lack of international travel impacted roaming revenues
- Lower retail store sales due to lockdown and low consumer income. This had a large impact on MSMEs which are at the consumer levels.
- Lower mobile money agents as there was a drive for cashless payments
- Government directive on mobile money cost of transaction.
- Lower fixed line income due to work from home guidelines

One of the positive to the industry is improved mobile and fiber network to meet demand increase in data traffic. This has led to growth in data revenues.

Sub-Sahara Africa (SSA) – Low Penetration

International Monetary Fund (IMF) projects SSA economy shrunk by 1.9% in 2020. The economy is forecasted to grow by 3.4% in 2021 and 4.0% in 2022. With financial penetration remaining low in the region, mobile penetration remains key to economic development. As of 2019, the telecommunication industry injected USD 155.00Bn into the economy and the contribution is expected to increase to USD 184.00Bn by 2025.

Sub-Sahara Africa remains a virgin market on mobile phone and internet connectivity. World Bank data put mobile cellular penetration stood at 78.9% in 2019. Rural penetration remains lower with 59.3% of the population living in the rural area.

Internet penetration is even lower with GSMA projecting only 26% of the SSA population had internet connectivity in 2019.

4% - 8% Loss in Revenues
Associated with Covid-19

4.8% Loss in HY-2021 Service
Revenues by Safaricom
Associated with Covid-19

IMF - SSA Growth Projection



Source: IMF, KSL

Mobile Economy SSA	2019	2025
Public Funding (USD Bn)	17	
Employment	650,000	
Connection by Technology	9%	27%
Operator Revenue & Investment (USD Bn)	44.30	48.70
Industry contribution to GDP (USD Bn)	155.00	184.00
Smart Phones	44%	65%
Sim Connection (Bn)	0.82	1.05
Sim Card Penetration	77%	86%
Unique Mobile Subscribers	447	614
Mobile Penetration Rate	45%	50%
Mobile Internet User	272	475
Mobile Internet Penetration Rate	26%	39%

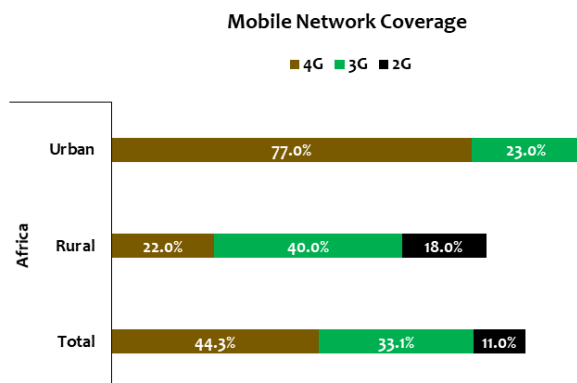
Source: GSMA, KSL

4.8% Loss in Service Revenues
by Safaricom Plc Associated
with Covid-19

The 5G Outlook – Pushing Ahead – 4G Still has Room to Grow

African 5G projects remain a near future implementation with Vodacom and MTN networks having launched 5G in South Africa. The continent continues with 4G which remains sufficient to meet current levels of demand and most internet use cases in the region. Cost of setting up and affordability of 5G devices will remain a challenge for African consumers for the foreseeable future.

In their report Measuring digital development Facts and figures 2020, International Telecommunication Union (ITU) put African Urban 4G penetration at 77% with 3G at 23%. Rural areas have lower 4G coverage of 22%, 3G at 40% while 2G is 18%.

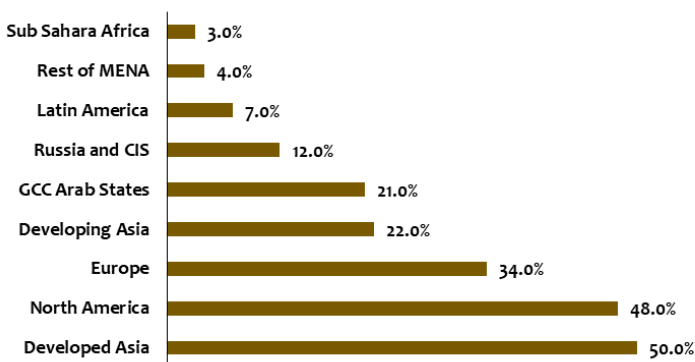


Source: ITU, KSL

According to GSMA, a 1.8Bn will be 5G connected by 2025. Sub-Sahara Africa connectivity will stand at 3.0% (38.97Mn). Grand View Research values global 5G market at USD 41.48Bn in 2020 and expected to grow at CAGR of 46.2% between 2021 – 2028.

Globally, there 113 operators with 5G network across 48 countries. They account for c.40% of global mobile subscribers.

5G Adoption in 2025



Source: GSMA, KSL

Kenya Telecommunication industry has grown in strides, subscription has grown at a 5-year CARG of 10.3% with penetration growing at 8.0%.

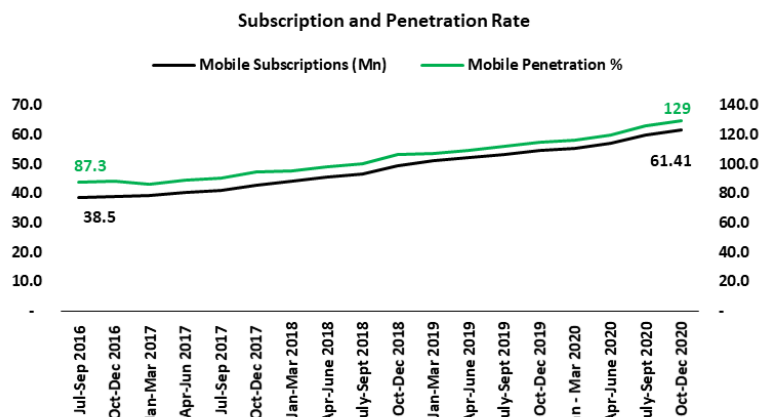
The growth in subscriptions and penetration has been championed by:

- Wide coverage especially in the rural areas
- Pricing effect leading to low cost of funding
- Mobile money which eases transaction. Mobile money subscription stands at 31.79Mn
- Cheap data readily accessible on mobile phones. Mobile data subscription is at 44.39Mn.
- Intentional drive by the government to grow communication and data

4G
Urban Penetration 77.0%
Rural Penetration 22.0%
Total 43.3%

3G
Urban Penetration 23.0%
Rural Penetration 40.0%
Total 33.1%

5G
1.8Mn Connection by 2025
CARG 46.2% 2021 - 2025



Source: CA, KSL

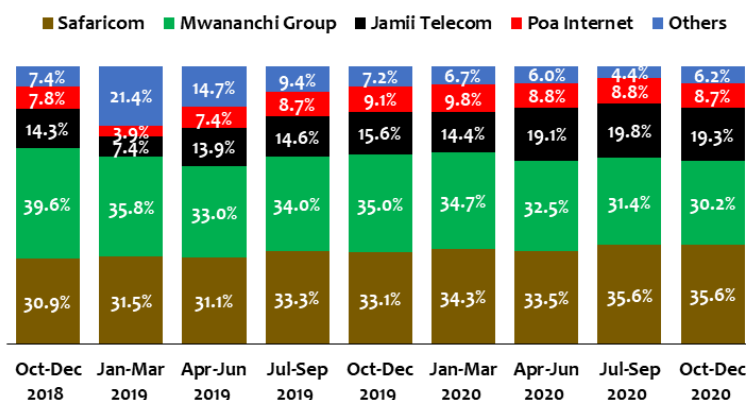
Data December 2020

- Subscription – 61.4Mn
- Penetration – 129.0%
- Mobile Money Subs – 31.79Mn
- Mobile Data Subs 43.71Mn
- Internet Subs - 44.39Mn

Safaricom Plc – The King Reigns

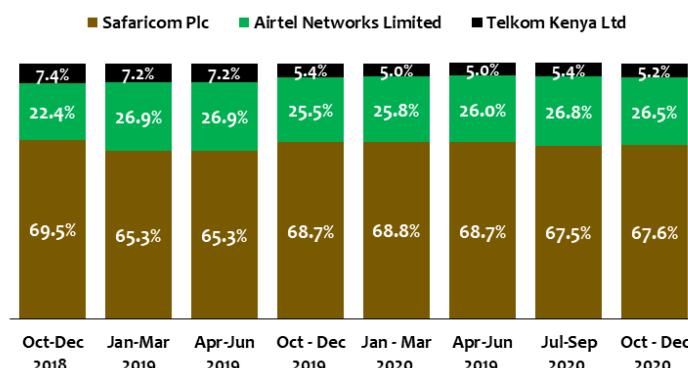
Safaricom Plc remains dominant in all aspect of telecommunication. Below is a pictorial of the standing

Fixed Data Market Share



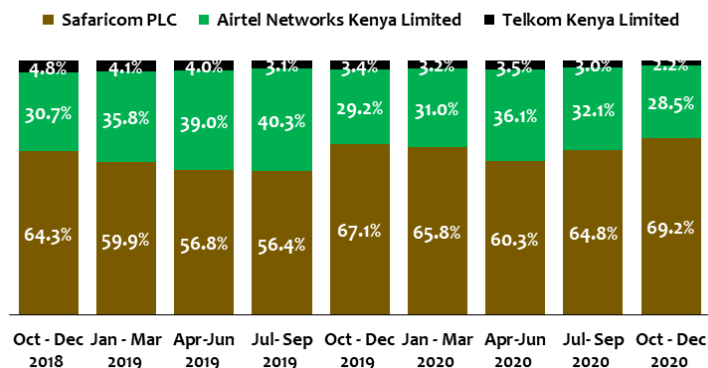
Source: CA, KSL

MOBILE INTERNET / DATA SUBSCRIPTIONS



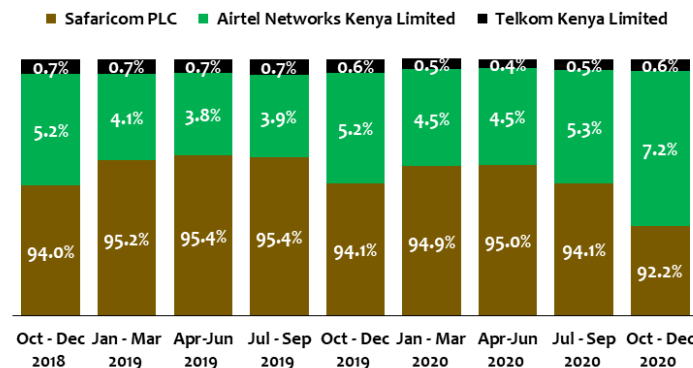
Source: CA, KSL

Voice Traffic Marke Share



Source: CA, KSL

SMS Traffic Market Share



Source: CA, KSL

Valuation:

We value Safaricom Plc at KES 37.73 per share, a 7.5% downside compared to closing price of KES 40.80. The market price has incorporated the news on the submission of proposal to acquire a license in Ethiopia but awaits the confirmation. We will provide an updated valuation once the license acquisition is confirmed.

We have used three methods, Discounted Cash Flow (DCF), Discounted Dividend Method (DDM) and EV/EBITDA methods. On our assumption, we used 5-year government due to the fast change in the speed of technology.

DDM we assumed a payout of 80% for the next 5-years.

Financial Valuation - Assumptions

Risk free rate	11.0%	5 Year Bond
Mature market risk premium	5.5%	Long Term
Beta (LTM)	1.00	Bloomberg
Cost of equity	16.5%	
Terminal growth rate	6.0%	Long Term GDP Growth Government Forecast
Equity: Debt	84.9%	
Cost of Debt	7.6%	50bps above 91-day T-Bill
Tax Rate	30.0%	
WACC	14.8%	
CRB	7.1%	
Gearing Cushion	0.5%	
No of Shares	40,065	
Valuation Day	9-May-21	
Current Share Price	40.80	
Days of the Year	365	

Source: CBK, Bloomberg, KSL

DCF	2021F	2022F	2023F	2024F	2025F
Year End	31-Mar-21	31-Mar-22	31-Mar-23	31-Mar-24	31-Mar-25
EBIT	94,869	109,740	124,156	135,671	149,748
EBIT(1-Tax)	71,152	76,818	86,909	94,970	104,824
Depreciation & Amortization	35,826	37,037	34,362	36,463	38,153
Capex	(40,299)	(38,714)	(43,653)	(42,740)	(45,444)
Changes in WC	(323)	(973)	(962)	(1,116)	(1,292)
Reinvestment	(4,796)	(2,650)	(10,253)	(7,393)	(8,584)
Operating Free Cash Flow	66,356	74,168	76,656	87,577	96,240
Terminal value					1,160,081
Time	(0.1)	0.9	1.9	2.9	3.84
Discount rate	1.01	0.89	0.77	0.67	0.59
PV of Net Cash Flow	990,805	67,316	65,669	59,236	739,519
Number of shares	40,065				
Value per share	24.73				
Current price per share	40.80				
Upside/Downside	-39.4%				

Source: KSL

DDM	2021F	2022F	2023F	2024F	2025F
Year End	31-Mar-21	31-Mar-22	31-Mar-23	31-Mar-24	31-Mar-25
Dividend	1.45	1.58	1.81	2.00	2.23
Terminal Value					26.91
Discounting Rate	0.98	1.15	1.35	1.58	1.85
	(0.10)	0.88	1.87	2.85	3.84
	1.43	1.82	2.44	3.16	53.90
Discounted Value	62.74				
Current Share Price	40.8				
Upside/Downside	53.8%				

Source: KSL

EV/EBIDA	2021F	2022F	2023F	2024F	2025F
Market Value of Equity	1,634,669	1,634,669	1,634,669	1,634,669	1,634,669
Market Value of Debt	7,392	6,756	6,148	5,589	5,080
Cash and Cash Equivalent	(38,829)	(51,173)	(69,426)	(91,402)	(116,335)
EV	1,603,232	1,590,253	1,571,391	1,548,856	1,523,415
EBITDA	130,695	146,777	158,518	172,134	187,901
EV/EBITDA	12.27	10.83	9.91	9.00	8.11
Next 12 Month EV/EBIDTA Comparable		6.83			
Intrinsic Value		1,003,133.57			
Plus: Cash		38,829			
Less: Debt		7,392			
Equity Value		1,034,570.71			
Equity Value/Share		25.82			
Current Share Price		40.80			
Upside/Downside		-36.7%			

Source: KSL

Target Price	Price	Weight	
FCFF	24.73	33%	8.23
DDM	62.74	33%	20.89
EV/EBITDA	25.82	33%	8.60
Target Price		100%	37.73
Current Share Price			40.80
Upside/Downside			-7.5%

Source: KSL

Financial Forecast:

Profit and Loss Account (KES Mn)	2019A	2020A	2021F	2022F	2023F	2024F	2025F
Revenues	250,283	262,556	255,038	277,212	299,136	324,563	354,007
Revenue Growth %	6.9%	4.9%	-2.9%	8.7%	7.9%	8.5%	9.1%
Direct Costs	(72,399)	(75,285)	(76,001)	(79,421)	(85,703)	(92,987)	(101,423)
Other expenses	(53,590)	(47,560)	(46,672)	(49,344)	(53,246)	(57,772)	(63,013)
EBITDA	124,304	138,042	130,695	146,777	158,518	172,134	187,901
EBITDA Margin	49.7%	52.6%	51.2%	52.9%	53.0%	53.0%	53.1%
Depreciation and Amortization	(35,332)	(36,548)	(35,826)	(37,037)	(34,362)	(36,463)	(38,153)
EBIT	88,972	101,494	94,869	109,740	124,156	135,671	149,748
EBIT Margin	35.5%	38.7%	37.2%	39.6%	41.5%	41.8%	42.3%
PBT	91,218	105,773	97,008	113,126	129,381	143,107	159,709
Tax	(28,727)	(32,115)	(24,252)	(33,938)	(38,814)	(42,932)	(47,913)
PAT	62,491	73,658	72,756	79,189	90,567	100,175	111,796
PAT YoY Change %	13.0%	17.9%	-1.2%	8.8%	14.4%	10.6%	11.6%
EPS	1.56	1.84	1.82	1.98	2.26	2.50	2.79
DPS	1.25	1.40	1.45	1.58	1.81	2.00	2.23

Source: Safaricom Annual Report, KSL

Balance Sheet (KES Mn)	2019A	2020A	2021F	2022F	2023F	2024F	2025F
Share Capital	2,003	2,003	2,003	2,003	2,003	2,003	2,003
Share Premium	2,200	2,200	2,200	2,200	2,200	2,200	2,200
Retained Earnings	65,219	82,785	90,061	105,899	124,012	144,047	166,406
Proposed Dividends	74,923	56,092	65,480	63,351	72,453	80,140	89,437
Total Equity	144,345	143,080	159,745	173,453	200,669	228,390	260,046
Non-Current Assets							
Deferred Income Tax	1,603	1,105	1,105	1,105	1,105	1,105	1,105
PPE	125,218	129,337	134,289	139,430	148,254	157,637	167,613
Indefeasible Rights of Use (IRUs)	3,553	3,252	2,951	2,650	2,349	2,048	1,747
Investment Property	845	845	845	845	845	845	845
Intangible Assets	7,385	6,026	8,135	6,915	9,335	7,935	6,745
Investment in Associates	150	4,965	4,965	4,965	4,965	4,965	4,965
Restricted Cash	1,846	1,912	1,937	1,962	1,987	2,013	2,039
	142,517	164,403	168,901	170,603	179,920	186,222	193,540
Current Assets							
Inventories	1,775	1,859	1,809	1,966	2,122	2,302	2,511
Receivables and Prepayments	18,126	17,190	17,003	18,481	19,942	21,638	23,600
Cash and Cash Equivalent	20,030	26,760	38,641	50,984	69,238	91,213	116,335
	49,959	48,822	60,465	74,444	94,315	118,165	145,459
Current Liabilities	-	-	-	-	-	-	-
Payables and Accrued Payables	28,704	29,920	30,004	32,613	35,192	38,184	41,648
Borrowings	4,032	8,000	7,392	6,756	6,148	5,589	5,080
	46,259	56,501	55,977	57,950	59,921	62,353	65,309
Net Current Liabilities	3,700	(7,679)	4,488	16,494	34,393	55,812	80,150
NAV	146,217	156,724	173,389	187,097	214,313	242,034	273,690

Source: Safaricom Annual Report, KSL

Cash Flow Statement	2019A	2020A	2021F	2022F	2023F	2024F	2025F
Net Cash Generated from Operating Activities	99,811	110,362	109,054	117,334	126,013	137,862	151,337
Net cash used in investing activities	(45,051)	(29,632)	(40,299)	(38,714)	(43,653)	(42,740)	(45,444)
Net cash used in financing activities	(44,227)	(74,001)	(56,874)	(66,277)	(64,106)	(73,147)	(80,770)
At start of the year	9,497	20,030	26,759	38,639	50,983	69,237	91,212
Increase/(Decrease) in cash and cash equivalents	10,533	6,729	11,881	12,344	18,253	21,975	25,122
At end of year	20,030	26,759	38,639	50,983	69,237	91,212	116,334

Source: Safaricom Annual Report, KSL

Key Ratios	2019A	2020A	2021F	2022F	2023F	2024F	2025F
Revenue Growth	6.9%	4.9%	-2.9%	8.7%	7.9%	8.5%	9.1%
EBITDA Margin	49.7%	52.6%	51.2%	52.9%	53.0%	53.0%	53.1%
EBIT Margin	35.5%	38.7%	37.2%	39.6%	41.5%	41.8%	42.3%
EBT Margin	35.5%	38.7%	37.2%	39.6%	41.5%	41.8%	42.3%
PBT Margin	36.4%	40.3%	38.0%	40.8%	43.3%	44.1%	45.1%
Net Margin	25.0%	28.1%	28.5%	28.6%	30.3%	30.9%	31.6%
ROaE	34.7%	36.3%	32.9%	33.4%	34.9%	34.6%	34.8%
ROaA	50.7%	52.1%	43.8%	47.7%	49.8%	49.5%	49.6%

Source: Safaricom Annual Report, KSL

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Analysts' stock ratings are defined as follows:

- **Buy** – A buy rating reflects 1) An analyst has a bullish conviction on a stock 2) A 30% or greater expected return.
- **Accumulate** – An accumulate rating reflects 1) An analyst has a lesser bullish conviction on a stock 2) Expected return falls between 10% and 30%.
- **Hold** – A hold rating reflects 1) An analyst has a neutral conviction (lack of bullish or bearish conviction) on a stock 2) Expected return falls within the range of 5% to 10%.
- **Speculative Buy** – A speculative buy rating reflects 1) An analyst has a bullish conviction accompanied by a substantially higher than normal risk 2) Expected return falls above 10%.
- **Sell** – A sell rating reflects 1) An analyst has a bearish conviction on a stock 2) Expected return falls below 5%.

*Expected Return (ER) represents the sum total of both capital appreciation and the dividend yield.

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