Safaricom FY23 Results

Earnings Commentary

Safaricom PLC FY23 Earnings

Kenyan operations remain resilient as Ethiopia takes shape.

May 12, 2023

Safaricom Plc (NSE: SCOM) FY23 key performance metrics missed our forecasts. First, the Group's net earnings of KES 1.55 per share fell shy of our forecast of KES 1.88. Second, EBIT came in at KES 85.0Bn, below our forecast of KES 97.0Bn. The underperformance was largely driven by the outsized operational costs in the Ethiopian business.

Shifting gears to the top line, Table 1 (below) captures actual performance (FY23A) against our estimates (FY23F).

Table 1: Top-line actuals vs forecasts

KES, Bn	FY23A	FY23F	Difference
Voice Revenue	81.1	83.2	2.60%
M-Pesa Revenue	117.2	118.9	1.46%
SMS Revenue	11.4	9.3	-18.23%
Mobile Data Revenue	54.0	53.6	-0.65%
Mobile Incoming Revenue	8.1	11.4	40.34%
Fixed Service Revenue	13.5	11.1	-17.27%
Other Service Revenue	10.6	13.4	26.65%
Total Service Revenue	**295.7**	**300.8**	1.74%
Other Income	15.2	10.4	-31.78%
Total Revenue	**310.9**	**311.2**	0.10%

Source: Genghis estimates & Company accounts

On the cost side, the Group's direct costs came in at KES 92.2Bn (+0.8% y/y) in line with our forecast of KES 92.7Bn. However, operating costs, at KES 74.1Bn (+34.2% y/y), were printed above our forecast of KES 61.9Bn.

The Board of Directors proposed a final dividend payment of KES 0.62 per share. This coupled with the KES 0.58 interim dividend payment brings the total dividend payment for the financial year 2022/2023 to KES 1.20 per share.

M-PESA revenues ride on increased utility (KES 117.20Bn, +8.8% y/y)

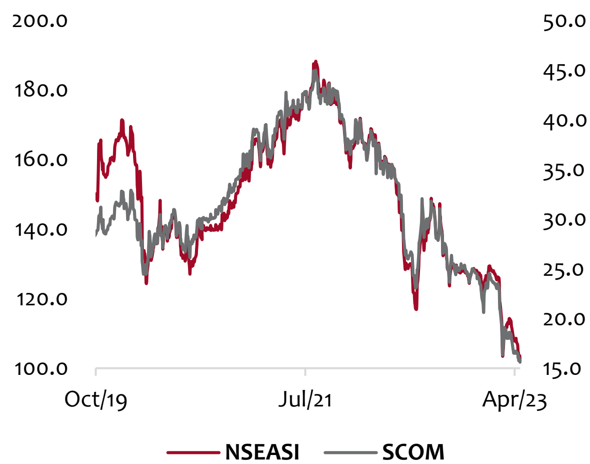
Despite missing our FY22 revenue forecast marginally, we are impressed by M-Pesa's revenue growth – which continues to ride on increased utility. Total transactional value and volumes for the period under review grew by 21.4% y/y and 33.5% y/y to KES 35.86Tn and 21.03Bn, respectively. The one-month active average revenue per user (ARPU) for M-Pesa grew by 1.9% y/y to KES 311.28 from KES 305.37 in a similar period last year.

Disbursements in the Group's overdraft facility, Fuliza, rose by 39.6% y/y to KES 701.5Bn. Repayment vs the disbursal rate however declined from 101.5% in FY22 to 95.7% in FY23 even as the average ticket size shrank to KES 298.0 (-13.7% y/y). Revenues from the overdraft facility in the financial year printed at KES 5.4Bn – an 8.3% y/y decline that is partly due to the waiver of daily maintenance fee for the first 3 days and the 50% maintenance fee reduction implemented in the close of 1H23.

Looking at the loan book, revenues from KCB M-Pesa declined by 8.3% y/y to c. KES 600Mn while M-Shwari registered 11.6% y/y growth in revenues to KES 2.1Bn.

Key Statistics	
Target Price	39.08
Market Price	14.70
Potential Upside	165.9%
Bloomberg Code	SAFCOM.KN
Reuters Code	SCOM.NR
NSE Code	SCOM
Free Float	20.5%
Price change YTD	-39.1%
52 Week High - Low	34.00 - 14.70
Market Cap (USD Bn)	4.3
P/E	9.5x
P/B	2.2x
Dividend Yield	8.2%

Source: Genghis Research, Company accounts, & NSE



Source: Genghis Research & NSE

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We believe that the loan book revenue performance is in part attributable to the disbursement levels in the period under review. KCB M-Pesa registered an 8.9% y/y cut to KES 42.2Bn while M-Shwari's disbursements grew 6.3% y/y to KES 91.5Bn.

M-Pesa Global revenue grew by 14.6% y/y to KES 2.84Bn. This was on the back of a 5.6% y/y rise in transactional value to KES 418.00Bn coupled with a 2.2% y/y rise in transactional volumes to 31.72Mn – which signals an overall rise in usage.

Going forward, we expect to see steady growth in M-Pesa revenues on the back of:

- Resumption of bank to M-Pesa and M-Pesa to bank charges.
- Increased utilization across the board. (Table 2 shows the CAGR growth over the years has remained strong. We believe the growth trajectory will remain steady in the mid-term as M-Pesa becomes ubiquitous.)
- A growth in ARPU. We forecast FY24 ARPU at KES 326, a 2% y/y growth.

Table 2: M-Pesa revenue contribution evolution

KES, Bn	FY20	FY21	FY22	FY23	FY23 y/y	3-Yr CAGR
Personal Payments	58.70	55.60	72.44	78.23	7.99%	10.05%
Business Payment	18.21	16.96	24.25	27.47	13.28%	14.69%
Global Payments	1.31	2.01	2.48	2.90	16.94%	30.33%
Financial Services	6.22	8.07	8.53	8.60	0.82%	11.40%
Total	**84.44**	**82.65**	**107.69**	**117.19**	**8.82%**	**11.54%**

Source: Genghis estimates & Company accounts

As a percentage of service revenue, the share of M-Pesa revenue grew by 3.5 percentage points year-on-year to 39.6%. We expect to see M-Pesa share growing even as the share of matured revenue lines declines.

Mobile Data, GSM's growth frontier (KES 53.95Bn, +11.4% y/y)

Mobile data revenue came in at KES 53.95Bn, slightly above our forecast of KES 53.60Bn. This was on the back of increased usage, with the one-month active mobile data customers growing by 3.4% y/y to 26.07Mn. The ARPU also rose by 16.2% y/y to KES 239.04 from KES 205.73 in a similar period last year.

We believe this revenue line will benefit from increased mobile data consumption as consumers' migration to over-the-top technologies (OTTP) continues. We note the commendable efforts in increasing coverage – with 4G base stations rising from 5,920 in FY22 to 6,232 by the close of 31st March 2023. We believe that the Group will close mobile data usage gaps as smartphone devices in the network continue to increase. In FY23, smartphone devices on the network grew by 10.0% y/y to 20.3Mn with 4G-enabled smartphone devices growing by 20.6% y/y to 13.2Mn.

An interesting development in this space going forward will be in the Group's strategy to either include or overlook satellite connectivity through the adoption of the Low Earth Orbit (LEO) constellation model. From our vantage point, we believe this inclusion – *which will likely reduce the cost structure, provide connectivity in hard-to-reach locations, and increase performance capability* – will place the Group in a better position to increase mobile data revenues despite data being price-sensitive, and pricing remaining the key proposition. This in our view, will see mobile data revenues growing astronomically (pun intended) thus absorbing the shocks in the GSM business as Voice and SMS close in on their saturation point.

As a percentage of service revenue, the share of Mobile data revenue grew by 5.9 percentage points year-on-year to 18.2% in FY23.

Increased connectivity drives fixed data (KES 13.46Bn, +19.7% y/y)

Fixed service revenue came in at KES 13.46Bn, outperforming our estimates of KES 11.13Bn. We are impressed with the customer growth - Home customers grew by 17.9% y/y to 195.7k while fixed enterprise customers grew by 10bps y/y to 48.4k.

Home customers' ARPU posted a smooth growth to KES 2,336 (+1.6% y/y). Fixed enterprise ARPU, on the other hand, registered a 9.9% y/y growth to KES 12,312. We believe the resumption to the office will be a tailwind for this revenue line going forward. However, the decline in activity rate (from 86% to 71%) in home customers remains a near-term concern.

As a percentage of service revenue, the share of fixed service revenue grew by 13.8 percentage points year-on-year to 4.6% in FY23.

SMS revenue grows while Voice continues to mature

Voice revenues printed at KES 81.05Bn (-2.6% y/y), below our projections of KES 83.16Bn. We note that both the APRU and the one-month active voice customers declined in the period under review. We believe this is on the back of the increased usage of SMS coupled with the growing consumer preference for OTTP technologies.

Voice ARPU dropped by 10bps y/y to KES 248.59 with one-month active customers dropping to 26.19Mn (-7.7% y/y).

SMS revenues came in at KES 11.38Bn (+4.6% y/y) outperforming our KES 9.30Bn forecast. This growth was anchored by 5.1% y/y growth in ARPU to KES 43.82 despite the 4.9% y/y decline in one-month active customers. We believe this outperformance was on the back of bespoke customer price propositions that enabled the Group to leverage its existing customer base.

However, we expect to see this revenue line declining, albeit smoothly, as SMS continues to close in on its saturation point which will pile downward pressure on ARPU.

Costs remain elevated

Direct costs came in at KES 92.23Bn (+80bps y/y) largely due to M-Pesa commissions that came in at KES 35.60Bn (+9.4% y/y). We note that handset costs declined by 11.8% y/y to KES 10.93Bn – thawing the 43.7% y/y surge printed last year.

Operating costs on the other hand grew 34.2% y/y to KES 74.09Bn largely due to employee benefits expenses that came in at 28.33Bn (+25.6% y/y). We believe that costs will remain elevated going forward on account of Ethiopia operations.

Ethiopia operations.

Of the KES 562.4Mn service revenue generated in the period, mobile data accounted for 63% of the service revenues with voice accounting for 24%. Adjusting service revenues to handset and other incomes, Safaricom Ethiopia printed KES 1.83Bn in total revenues for the period ending 31st March 2023.

Operating costs on the other hand printed at KES 19.98Bn with direct costs at KES 1.80Bn. This on further adjustments placed the company's bottom line at a loss of KES 21.61Bn. We see great potential in the business from these numbers given the launch of commercial operations was in 2H23.

We believe with the mobile money license in play, Safaricom Ethiopia is set to see stellar growth in its top line in FY24 even as the Group works on accelerating the coverage rollout. In our view, the aggressive coverage upscale and the soon-to-start M-Pesa operations will be instrumental in actualizing the 4-year break-even target.

FY24 Guidance

Safaricom's FY24 guidance for capital expenditure (Capex) is between KES 82Bn and KES 90Bn, with c. KES 45Bn Capex allocation for expansion into Ethiopia. We believe that Capex will remain elevated in the mid-term – now that Ethiopia is in sight.

The EBIT guidance for FY24 is range bound between KES 117Bn and KES 120Bn for operations in Kenya and KES 75Bn and KES 81Bn for the overall Group. This places Ethiopia's EBIT at a negative of KES 42Bn to KES 39Bn. We expect to see a revision in guidance in 1H24 to account for mobile money operations in Ethiopia and revenue growth as coverage increases.

Our View:

Despite missing our FY23 expectations, we retain our valuation numbers. Consequently, we retain a BUY recommendation on the stock. We opine that the current market price is below its fair value estimate which presents investors with c.166% in capital gain prospects.

We believe that the Group's fundamentals remain strong and will be able to weather the ongoing macro economical shakeups. As such, we advise investors to take advantage of the discounted entry levels and remain invested in the long term.

Income Statement	FY18	1H19	FY19	1H20	FY20	1H21	FY21	1H22	FY22	1H23	FY23	Y/Y
Voice Revenue	95.6	47.5	95.8	43.0	86.5	40.2	82.6	41.5	83.2	39.9	81.1	-2.6%
M-PESA Revenue	62.9	35.5	75.0	42.0	84.4	35.9	82.6	52.3	107.7	56.9	117.2	8.8%
SMS Revenue	17.7	9.7	19.6	7.7	15.4	7.2	13.6	5.9	10.9	5.4	11.4	4.6%
Mobile Data Revenue	36.4	19.0	36.3	19.5	40.2	22.2	44.8	23.6	48.4	26.3	54.0	11.4%
Fixed Service Revenue	6.7	3.8	8.1	4.6	9.0	4.5	9.5	5.5	11.2	6.8	13.5	19.7%
Other Service Revenue	5.2	2.5	5.0	3.4	7.2	3.8	7.8	4.7	9.8	5.2	10.6	7.7%
Total Service Revenue	**224.5**	**118.1**	**239.8**	**124.3**	**251.2**	**118.4**	**250.4**	**138.4**	**281.1**	**144.8**	**295.7**	**5.2%**
Other Revenue	9.7	4.8	10.5	5.6	11.3	6.1	13.7	7.9	17.0	8.6	15.2	-10.4%
Total Revenue	**234.2**	**122.8**	**250.3**	**129.9**	**262.6**	**124.5**	**264.0**	**146.4**	**298.1**	**153.4**	**310.9**	**4.3%**
Direct & Construction costs	70.8	35.3	72.4	37.5	75.3	37.5	80.9	44.5	91.5	46.8	92.2	0.8%
Contribution Margin	**163.5**	**87.6**	**177.9**	**92.1**	**185.6**	**84.6**	**180.2**	**100.8**	**204.2**	**105.0**	**213.9**	**4.7%**
Operating & Other costs	50.6	25.8	53.6	23.7	47.5	21.2	46.0	23.4	55.2	31.0	74.1	34.2%
EBITDA	**112.8**	**61.8**	**124.3**	**68.4**	**138.1**	**63.4**	**134.1**	**77.4**	**149.1**	**74.0**	**139.9**	**-6.2%**
Depreciation & Amortization	33.6	17.6	35.3	18.1	36.5	18.4	38.0	19.5	39.9	22.8	54.9	37.4%
EBIT	**79.3**	**44.2**	**89.0**	**50.2**	**101.5**	**45.0**	**96.2**	**57.9**	**109.1**	**51.2**	**85.0**	**-22.1%**
PBT	**79.9**	**45.6**	**91.2**	**51.3**	**105.8**	**44.7**	**93.7**	**54.7**	**102.2**	**48.3**	**88.3**	**-13.6%**
Tax	24.6	14.5	28.7	16.1	32.1	11.7	25.0	17.6	34.7	18.0	35.9	3.3%
PAT	**55.3**	**31.2**	**62.5**	**35.2**	**73.7**	**33.1**	**68.7**	**37.1**	**67.5**	**30.2**	**52.5**	**-22.2%**

Balance Sheet	FY18	1H19	FY19	1H20	FY20	1H21	FY21	1H22	FY22	1H23	FY23	Y/Y
Non-current assets	**140.0**	**139.7**	**142.5**	**144.0**	**164.4**	**178.0**	**174.7**	**275.2**	**281.5**	**311.3**	**436.8**	**55.1%**
Inventory	1.6	2.1	1.8	2.0	1.9	3.9	2.5	4.1	4.3	7.3	3.7	**-15.1%**
Receivables	15.9	20.6	18.1	20.3	17.2	23.3	22.3	23.4	25.9	36.0	40.8	**57.4%**
Cash and cash equivalents	9.5	36.7	20.0	23.3	26.8	15.8	26.7	26.5	30.8	16.0	22.1	**-28.2%**
Other assets	0.5	2.7	10.0	21.6	3.0	6.6	4.3	4.5	4.2	8.9	5.9	**38.8%**
Total Assets	**167.4**	**201.7**	**192.5**	**211.2**	**213.2**	**227.6**	**230.6**	**333.6**	**346.8**	**379.4**	**509.2**	**46.8%**
Contract liabilities	8.9	10.0	9.3	9.9	9.4	9.4	11.0	10.4	10.2	10.6	10.1	-0.8%
Payables	26.5	38.0	28.7	33.8	29.9	40.8	34.0	37.2	41.3	52.1	72.7	75.9%
Other liabilities & equity	132.1	153.7	154.5	167.5	173.9	177.4	185.6	285.9	295.3	316.7	426.4	44.4%
Total Liabilities & Equity	**167.4**	**201.7**	**192.5**	**211.2**	**213.2**	**227.6**	**230.6**	**333.6**	**346.8**	**379.4**	**509.2**	**46.8%**

source: Company accounts

Select Key Line Items (KES Bn)	FY18	1H19	FY19	1H20	FY20	1H21	FY21	1H22	FY22	1H23	FY23	Y/Y
Voice Revenue	95.6	47.5	95.8	43.0	86.5	40.2	82.6	41.5	83.2	39.9	81.1	-2.6%
M-PESA Revenue	62.9	35.5	75.0	42.0	84.4	35.9	82.6	52.3	107.7	56.9	117.2	8.8%
Total Service Revenue	**224.5**	**118.1**	**239.8**	**124.3**	**251.2**	**118.4**	**250.4**	**138.4**	**281.1**	**144.8**	**295.7**	**5.2%**
Contribution Margin	163.5	87.6	177.9	92.1	185.6	84.6	180.2	100.8	204.2	105.0	213.9	4.7%
EBITDA	112.8	61.8	124.3	68.4	138.1	63.4	134.1	77.4	149.1	74.0	139.9	-6.2%
EBIT	79.3	44.2	89.0	50.2	101.5	45.0	96.2	57.9	109.1	51.2	85.0	-22.1%
EPS	**1.38**	**0.78**	**1.56**	**0.88**	**1.84**	**0.83**	**1.71**	**0.92**	**1.74**	**0.84**	**1.55**	**-10.9%**
Voice to Service Revenue	42.6%	40.3%	40.0%	34.6%	34.4%	33.9%	33.0%	29.9%	29.6%	27.5%	27.4%	-7.4%
M-PESA to Service Revenue	28.0%	30.1%	31.3%	33.8%	33.6%	30.3%	33.0%	37.8%	38.3%	39.3%	39.6%	3.5%
EBITDA Margin	48.2%	50.3%	49.7%	52.6%	52.6%	50.9%	50.8%	52.9%	50.0%	48.3%	45.0%	-10.0%
EBIT Margin	33.8%	36.0%	35.5%	38.7%	38.7%	36.1%	36.4%	39.6%	36.6%	33.4%	27.3%	-25.3%
ROE	47.8%	60.0%	46.6%	64.6%	51.3%	29.4%	48.9%	24.8%	42.5%	16.5%	23.7%	-44.2%

source: Company accounts

Revenue Contribution	FY18	1H19	FY19	1H20	FY20	1H21	FY21	1H22	FY22	1H23	FY23
Voice to Service Revenue	42.6%	40.3%	40.0%	34.6%	34.4%	33.9%	33.0%	29.9%	29.6%	27.5%	27.4%
M-Pesa to Service Revenue	28.0%	30.1%	31.3%	33.8%	33.6%	30.3%	33.0%	37.8%	38.3%	39.3%	39.6%
SMS to Service Revenue	7.9%	8.2%	8.2%	6.2%	6.1%	6.1%	5.4%	4.2%	3.9%	3.7%	3.8%
Mobile Data to Service Revenue	16.2%	16.1%	15.1%	15.7%	16.0%	18.8%	17.9%	17.1%	17.2%	18.2%	18.2%
Fixed Service to Service Revenue	3.0%	3.3%	3.4%	3.7%	3.6%	3.8%	3.8%	4.0%	4.0%	4.7%	4.6%
Other Revenue to Service Revenue	2.3%	2.1%	2.1%	2.8%	2.9%	3.2%	3.1%	3.4%	3.5%	3.6%	3.6%

source: Company accounts

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