Recommendation:

SELL

Target Price: **KES 25.20**

Price on 10th May 2018:
KES 28.00

Potential Upside/Downside:
11.00%

52-week Trading Range:
KES 33.50 to KES 19.85

EPS:
KES 1.38

P/E
21.0x

ROaE
47.8%

ROaA
30.1%

Dividend Yield:
3.8%

Market cap:
KES 1,161.9 Bn

Estimated free float:
25.1%

Shares Outstanding:
40,065.4 Million

Latest Full Year Results:
The full Year 2018

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SAFARICOM PLC

Growth engine, M-PESA & Mobile Data, abates in FY18.

Safaricom PLC has just released it's Full-Year results for 2018 (**FY18**). The diversified telecommunications operator posted a **13.1%** increase in Profit Before Tax (PBT) to **KES 79.9Bn** in FY18 compared to FY17 PBT of **KES 70.63Bn.** The growth of PBT excluding the one-off **KES 3.35 Bn** adjustment of EBIT in FY17 was, however, **18.8%.** The **18.8%** growth of PBT was close to the **18.0%** growth projected in March. The actual realized PBT in FY18 was **KES 0.51 Bn** higher than our estimated FY18 PBT of **KES 79.4Bn** based on our report released on the 8th of March 2018.

The Profit after Tax (PAT) braved headwinds in the Full Year 2018 to grow by **14.1%** (or a normalized growth **of 19.9%**). The FY18 PAT crossed a new milestone of **KES 55.39Bn** from a FY17 PAT of **KES 48.44Bn**. The growth of **14.1%** was the slowest bottom line growth for the Telco since 2012 when it recorded a **4% decline** in Net Income.

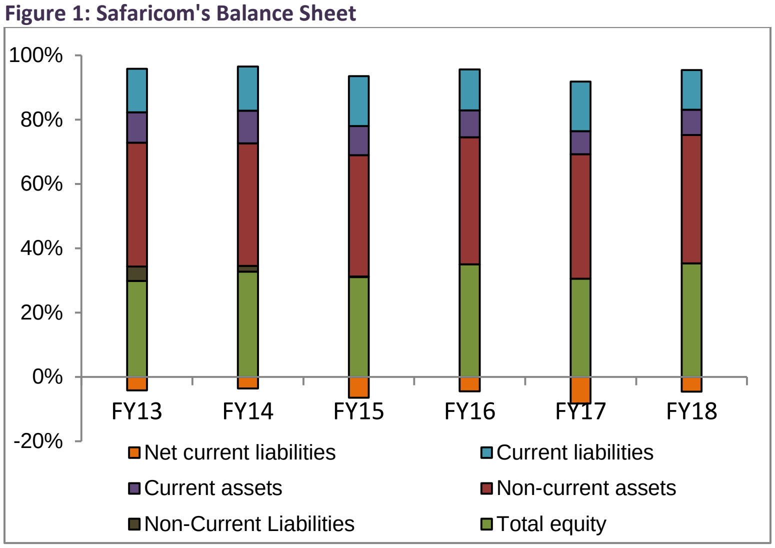
The board proposed a payment of a first and final FY18 dividend of **KES 1.10** per share, a **14.4%** increase in from the FY17 dividend of **KES 0.97**. The dividend was well within our expectation of a FY18 dividend of **KES 1.11** and was approximately **80%** of FY18's EPS of **KES 1.39.**

Balance Sheet: *Net Assets Firms Up.*

Safaricom's management grew the company's Total Assets by **3.6%** from **KES 161.7Bn** in FY17 to **KES 167.4Bn** in FY18. Total Liabilities on the balance sheet, in divergence with Total Assets, were downsized by **KES 10.67Bn** to **KES 43.53Bn** in FY18 from an FY17 Total Liability of **KES 54.20 Bn**. The marked decline in Total Liability was driven by the payment of **75.6% (or KES 12.5Bn)** of Safaricom's short-term borrowings during FY18 to **KES 4.04Bn** from **KES 16.54Bn** worth of short-term borrowing in FY17. The reduction of short-term debt helped the company firm up it's Net Cash position to **KES 5.46Bn** in FY18 from a negative **KES 10.58Bn** in FY17.

The firming up of Total Assets and the reduction of Liabilities improved Safaricom's Net Asset position to **KES 123.9Bn** in FY18, an upswing of **15.3%,** from the Net Asset position of **KES 107.49Bn** seen in FY17. The improvement of Net Asset was only marginally weaker than our expectation of a **15.6%** increase of Net Assets to **KES 124.2 Bn** in **FY18.**

Figure 1: Safaricom's Balance Sheet

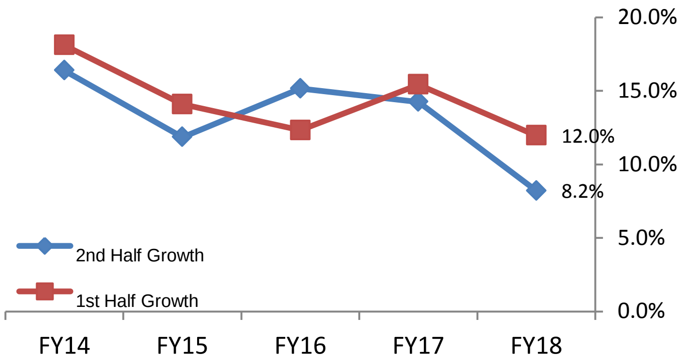


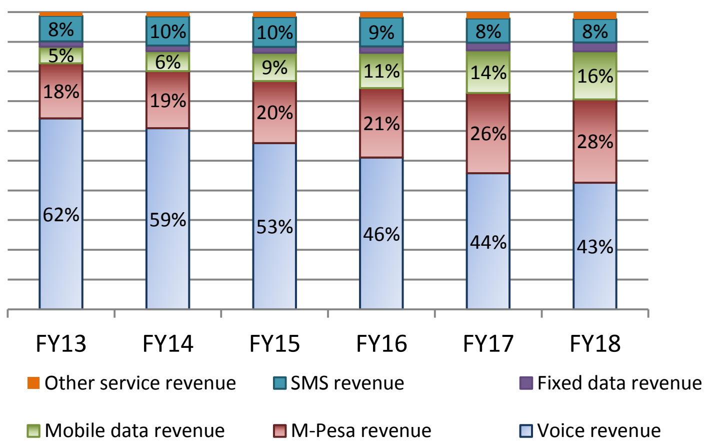
Source: Financial Statements, AIB Capital

Service Revenues: *Strong evidence of a Slowdown in the Second Half*

In the FY18, Safaricom recorded the slowest service revenue growth since FY11, when service revenue grew only by **9.8% (YoY).** The service revenues in FY18 grew by **10% (YoY)** to **KES 224.54Bn** from **KES 204.1Bn** achieved in FY17; in spite of it losing between **1.8ppts** to **2.8ppts** in market share due to 'political attacks' according to a report released by the Communications Commission of Kenya (CCK). The actual service revenue growth in FY18 was at **10% (YoY)**; contrary to our predicted **15% (YoY)** – in absolute terms, **10.7Bn** below the projected **235.3 Bn.** The slower than expected growth of Service Revenue in FY18 was primarily driven by a weaker second half performance in FY18. The Second Half of the Full Year 2018 (**H2Y18**), witnessed a slowdown of service revenue growth to **8.2% (YoY)** from **14.2% (YoY)** achieved during the same six month period in FY17.

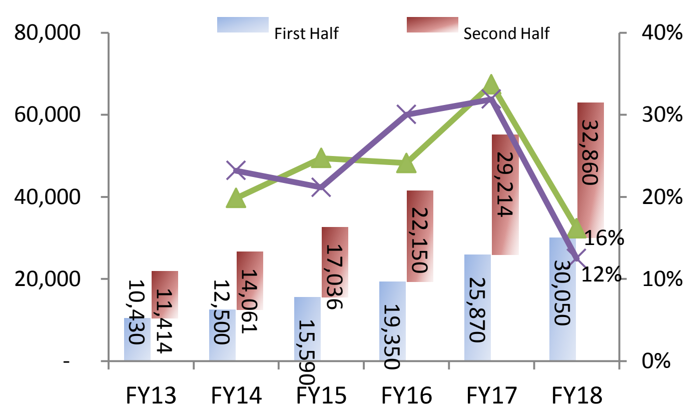
Safaricom's service revenue despite the slowdown still continues on its path of diversification with voice revenue falling to **43%** of service revenue in FY18 down from **62%** penned in FY13, just five years ago. Safaricom's dependence on legacy revenue from SMS and Voice services has also fell in FY18 with mobile data and M-PESA combined contributing **44%** of total revenue up from **23%** recorded in FY13.

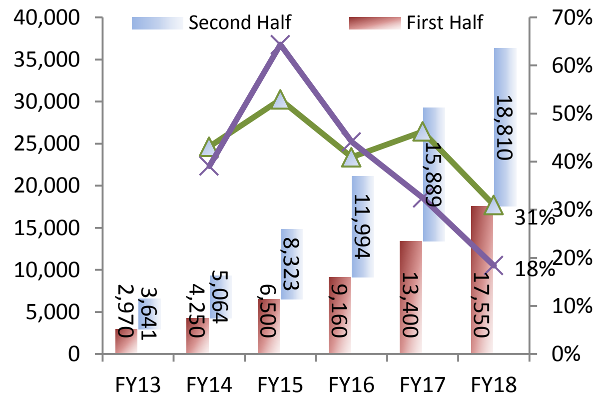




M-PESA & Mobile Data Revenue: *Soft growth from the big Growth Segments*

High inflation, political uncertainty, low private credit growth and low household consumption in FY18 drove Safaricom to report solid but unimpressive M-PESA and Mobile Data numbers. Safaricom recorded solid a **14%** growth of M-PESA revenues in FY18 to **KES 62.91 Bn** from **KES 55.08 Bn** recorded in FY17. The FY18 M-PESA revenue growth was almost **19** percentage points (pp) lower than the **33%** growth booked in FY17 and almost **12** percentage points (**pp**) lower than our expectation of **27.5%** growth in FY18**.** M-PESA revenues growth seemed to have suffered the most in the penultimate second half of the year when political uncertainty was at its highest and household consumption at its lowest. Half Year M-PESA revenue in the second half only grew by **12%** (YoY), down **2pp** from **16%** (YoY) growth of Half M-PESA Year revenues in FY17.





Mobile data also underperformed in FY18 after succumbing to the same macroeconomic headwinds highlighted in the previous paragraph. Safaricom managed again to report solid but underwhelming Mobile data revenues. The actual mobile data revenues grew at a respectable **24%** to hit **KES 36.36Bn** in FY18 from **KES 29.29Bn** recorded in FY17. The actual growth of **24%** was a full **7.9pp** below our projected mobile data revenue growth of **34%** to **KES 39.24Bn** in FY18 and **14pp** slower than the 38% growth penned in FY17**.** The higher sensitivity of mobile data to household consumption compared to M-PESA meant that Mobile data recorded the faster deceleration in growth in the second half of FY18 of **14pp** from **32%** (YoY) growth in FY17 to **18%** (YoY).

Margins and Ratios:

Margin	***FY16A***	***FY17A***	***FY18A***
Gross Margin	*62.70%*	*67.60%*	*69.80%*
EBITDA Margin	*42.60%*	*48.60%*	*47.00%*
EBIT Margin	*29.20%*	*34.20%*	*33.80%*
Net Profit Margin	*19.50%*	*22.80%*	*23.60%*
Ratios	***FY16A***	***FY17A***	***FY18A***
Return on Equity	*34.50%*	*43.20%*	*47.80%*
Return on Assets	*22.60%*	*28.40%*	*30.10%*
Return on Capital	*30.80%*	*37.80%*	*39.30%*

Challenges:

Regulatory pressure remains a key challenge to Safaricom's dominance and the management's ability to continue create value for investors. The regulator, Communications Authority of Kenya is still mulling over the introduction of price controls as proposed by Analysys Mason. Although at this stage there is little likelihood of the price controls being implemented given the Kenyan government's conflict of interest, the government is still a major shareholder in Safaricom, we urge investors to stay vigilant to the adverse effects such a regulation. Price controls in Voice and SMS segments will most likely drive the industry volumes of both downwards and impede Safaricom's ability to stay competitive in the face of Over the Top (OTT) Players and compete against other Telco Players in Kenya.

Outlook 2018:

We currently project a **20%** increase in FY19 EPS to **KES 1.69** from **KES 1.38** because Safaricom could benefit from macroeconomic tailwinds in FY19. The favourable macroeconomic conditions includes: the recovery of the Kenyan economy in 2018, the increase in household demand in FY19, stabilization of the political environment and increased demand to their products during the low inflation period in FY19. Better income in 2018 will be especially crucial in potentially increasing the volumes demanded for voice, data and SMS. We also opine that the possibility of an increase in GDP and the expected increase in volume of trade in FY19 lifted by improved household consumption will help drive M-PESA revenue growth upwards towards our projected 4-year CAGR of **21%.**

Valuation:

We iterate our previous **SELL** recommendation due to the current persistent disconnect between market valuation of Safaricom and its fundamentals. Safaricom still trades at what we consider a demanding market multiples of a **P/E** of **20.29x**, a **P/B** of **9.5x** and **EV/EBITDA** of **10.25** compared to the Sub-Saharan **Median P/E** of **16.26x, Median P/B** of **2.89x** and **Median EV/EBITDA** of **8.27x**. We have now updated our twelve months Target price to **KES 25.00** per share to account for time value of money and for changes in market relative valuations. We also see an opportunity for investors to earn a dividend of **KES 1.33** at the end of FY19, 21% more than the currently proposed dividend of **KES 1.10**.

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