SAFARICOM PLC Valuation Update and 1H25 Results Expectations: Stuck in the middle

Safaricom PLC (SAFCOM KN) is due to publish its 1H25 results on 7th November 2024.

We update our Fair Value per share to KES 33.13 from KES 30.27. We retain our BUY recommendation with an upside of 97.8%. We retain our base case – in the medium-term, Safaricom PLC will partly restore its above industry ROIC (in the last 5 years, Safaricom Kenya's ROIC has been more than double its peers').

Our base case view is supported by the continued better -than-expected performance in the Kenyan subsidiary. However, Safaricom Telecommunication Ethiopia (STE) business has continued to disappoint. We have cut STE's long-term revenue forecasts, and we now expect STE to break-even at EBITDA level in 1H28 and not in 1H27. Our STE forecasts do not capture likely margin erosion tied to the devaluation of the Ethiopian currency at the end of August 2024– we await management's guidance on STE's tariff price changes following price revisions by Ethiopia Telecommunication (Ethiotel).

So, why do we see Safaricom PLC as being **stuck in the middle?**

At a share price of KES 16.75, Safaricom PLC is trading at an EV/EBITDA multiple of 5.1x, a 21.2% premium to its peers. Assuming that Safaricom PLC's EBITDA and ROIC were to remain at FY24 levels over the medium-term, a rather pessimistic assumption given management's earlier guidance that STE's loss will level off in FY24, the stock would be trading at KES 8.64 and an EV/EBITDA multiple of 3.1x (not far off from MTN Group, MTN Ghana, Airtel Africa Group and Sonatel). The 5.1x EV/EBITDA establishes that investors expect improved EBITDA and ROIC – but to levels that are below our forecasts (our Fair Value is based on a sum-of-parts valuation approach with an exit EV/EBITDA multiple of 7.1x for Safaricom Kenya which accounts for 97% of our Fair Value).

In addition, Safaricom Kenya is operating at peak EBITDA margins and delivering above historical dividend yield; however, STE continues to underperform in addition to facing increasing operational risks.

Safaricom PLC forecast summary:

KES (bn)	FY24A	FY25F (new)	FY26F (new)	FY25F (old)	FY26F (old)	FY25 chg	FY26 chg
Revenue	349	396	429	371	400	6.6%	7.3%
EBITDA	163	186	198	155	169	19.9%	16.8%
PAT	43	47	56	46	54	3.0%	5.0%
Minority interest	(20)	(25)	(24)	(20)	(20)	22.3%	21.8%
Attributable profit	63	72	80	66	73	8.9%	9.5%
EPS	**1.57**	**1.80**	**2.01**	**1.65**	**1.83**	**8.9%**	**9.5%**

FY25 Management guidance vs. Our forecasts:

KES (bn)	FY25F	FY25 Guidance
EBIT (Kenya)	151	149 - 152
EBIT (STE)*	(64)	(46) - (43)
EBIT (Group)*	87	103 - 109

**STE's reported and EBIT guidance are different owing to hyperinflationary adjustments. In FY24, STE's reported EBIT was KES -59.6bn. In setting STE's FY25 EBIT guidance, management reference EBIT number was KES -45.0bn. Our FY25 EBIT forecast for STE is based off FY24's reported EBIT.*

Key FY25 & FY26 forecast revisions:

Drivers	Change	Our view
		Kenya
Revenue	Positive	▪ 6.6% and 7.7% increase in our FY25 and FY26 forecasts, respectively. ▪ The increase is mostly driven by mobile and fixed data revenues amidst stable prices and higher usage, and new connections, respectively. Fixed data offers Safaricom compelling growth opportunity in a fragmented market. ▪ We have scaled back our SMS and Voice revenue declines as both revenue lines have remained resilient. Management has noted that the resilience in both lines has been a surprise, and that it could be a possible signal of change in user behaviour – in our view, we believe the steadiness has been supported by increased use of bundled voice, SMS & data offers.
EBITDA margin	Positive	▪ 54.5% and 53.2%, in FY25 and FY26, up from 49.5% and 49.0%, respectively. ▪ In the last 5 years, barring FY21, Safaricom has registered positive margin improvement. FY24's EBITDA margin of 54.5% was the highest in its history. The positive margin evolution, in our view, is the hallmark of the current management team. While it has fallen short in rolling out the next big innovation, it has more than made up for it by optimizing the business.
PAT	Positive	▪ 12.2% and 12.3% increase in our FY25 and FY26 forecasts, respectively. ▪ The increase is backed by our revised revenue and margins. The increase is also supported by; steady depreciation as we expect capital intensity to remain within the 13.5%-14.0% range, reduced interest expense led by lower interest rates and debt pay-down, and unchanged effective tax rate.
		Ethiopia
Revenue	Positive	▪ 6.8% and 3.4% increase in our FY25 and FY26 forecasts, respectively. ▪ The increase in total revenue is significantly driven by our revised mobile data revenue numbers on account of continued higher-than - expected usage - striking the right mix between user numbers and ARPU's remains a key challenge this early on in STE's operations. ▪ We have cut our total STE user numbers to 9.9m and 15.0m, from 15.0m and 23.0m, respectively. Customer acquisition has underperformed, with access to parts of the country still limited, coupled with Ethiotel's aggressive pricing and brand revamp. We have cut STE's expected FY30 user market share to 34.6% from 38.2%. We have retained our key assumption that STE's user base will significantly comprise of new mobile phone users and dual SIM users – acquiring users outright from Ethiotel will remain a daunting task.
EBITDA (Loss)	Negative	▪ 2.9% decrease and 18.6% increase in our FY25 and FY26 forecasts, respectively. ▪ The forecast reduction in FY25 EBITDA loss is mostly as a result of our revenue revision of 6.8% outpacing our 2.2% increase in total OPEX. This is however reversed for FY26, for which we have increased total

		OPEX by 6.8%. In FY25 and FY26, we expect total OPEX to grow by 28.2% y/y and 18.5% y/y, respectively. ▪ In line with our cut in customer numbers over our forecast period, we have revised our FY30 EBITDA margin down to 29% from 36% (management guidance is 40%.)
PAT (Loss)	Negative	▪ 22.3% and 21.8% increase in our FY25 and FY26 forecasts, respectively. ▪ The increase in forecasted loss is mostly driven by higher depreciation, as roll-out of base stations lags customer acquisition, and higher financing costs as cashflow generation falls behind – we have assumed that a large proportion of Vendor payments falling due in FY25 & FY26 will be financed using new bank debt (management has indicated that negotiations to extend Vendors' payment period are ongoing).

Valuation:

Safaricom Kenya Valuation:

KES (bn)		**FY25**	**FY26**	**FY27**	**Terminal value**
Free cash flow		98.05	103.18	107.67	
WACC		15.3%	15.3%	15.3%	
Discount factor		0.94	0.82	0.71	
PV FCF		**92.5**	**84.4**	**76.4**	
Sum PV FCF	**253.2**				
PV Terminal value	**1,091.8**				**1,540**
Add: cash	19.1				
Less: Debt	77.7				
Equity value	**1,286.4**				
Outstanding shares	40.1				
Per share value (KES)	**32.11**				

Key variables:

1. Cost of equity of 17.5%
2. Debt to equity of 27.8%
3. Terminal value is based on an Exit EV/EBITDA of 7.1x. The computation is based on our exit EBITDA & ROIC stacked up against Safaricom's 5-year historical median EV/EBITDA, EBITDA & ROIC

STE Valuation:

KES (bn)	
FY30 Revenue	105.98
EBITDA Margin	29%
EBITDA	**30.73**
Net profit margin	18%
PAT	19.08
PE - SSA Telecom's (5-years median)	11.18
Terminal value	**213.30**
Discount rate	20%
PV of terminal value	**79.49**
Safaricom holding	51.67%
Equity value attributable to Safaricom	**41.07**
STE's addition to Safaricom FV per share (KES)	**1.03**

Safaricom Group Valuation:

Safaricom Kenya (KES per share)	32.11
STE (KES per share)	1.03
Safaricom PLC valuation (KES per share)	**33.13**
Current price	16.75
Upside/downside	**97.8%**

1H25 Results expectation:

(KES bn)	**1H24A (Group)**	**1H25F (Kenya)**	**1H25F (STE)**	**1H25F (Group)**	**% chg**
Service Revenue	**159.1**	**178.0**	**6.8**	**184.8**	**16.2%**
Voice Revenue	43.2	39.8	1.3	41.1	-4.9%
SMS Revenue	5.8	6.3	0.5	6.8	17.8%
Mobile Data Revenue	30.9	37.5	4.7	42.2	36.4%
Fixed Data revenue	7.4	9.5	-	9.5	29.4%
M-Pesa Revenue	66.2	75.0	0.4	75.3	13.7%
Other service revenue	5.6	9.9	-	9.9	75.5%
Total Revenue	**164.6**	**184.5**	**8.7**	**193.2**	**17.4%**
EBITDA	**79.7**	**100.6**	**(10.3)**	**90.4**	**13.4%**
EBITDA margin	48.4%	54.5%	-118.1%	46.8%	
EBIT	**41.6**	**73.9**	**(33.1)**	**40.9**	**-1.7%**
Net income	14.2	48.2	(26.6)	21.5	
Hyperinflation gain	13.0				
Net profit	**27.2**			**21.5**	
Minority interest	(7.0)			(12.9)	84.5%
Attributable profit	**34.2**			**34.4**	**0.7%**
EPS (KES)	**0.85**			**0.86**	**0.7%**

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