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Safaricom – Initiation of Coverage

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From Dumb Pipes to Smart Pipes

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EXECUTIVE SUMMARY

We initiate coverage on Safaricom with a BUY RECOMMENDATION.

According to GSMA Intelligence, global SIM connections grew at a CAGR of 9.9% in the 2008-2014 period to 7,057 million (7.4 billion including Machine to Machine (M2M) connections), representing a SIM penetration of 97.2% (68.1% of the addressable population). Over the same period, unique subscribers, which represents the estimated number of persons (as opposed to SIM connections) using mobile services, grew at a CAGR of 7.6% to 3,636 million.

Although the growth rate in subscriptions is expected to taper for the period 2014-2020 for all regions, Sub-Saharan Africa will experience the highest growth rate in subscriptions on the back of low penetration levels. However Average Revenue per User (ARPU) is and will remain the lowest compared to other regions.

The growth story in Kenya is the same with rest of Sub Saharan Africa. On a unique subscriber perspective, according to Analysys Mason, Kenya's penetration is estimated at 50.0%, which provides some headroom for growth in subscriptions. We expect new subscriptions to have a preference for non-voice services, notably mobile data and mobile money services. We therefore expect these non-voice services revenues to contribute more in growth for the industry.

Safaricom has consistently maintained market leadership in all retail mobile segments which we attribute to the company's superior network spend and a deep understanding of the local market. With the accelerated investments in network improvement, diversified product offering, the company's efforts to tap into a wider innovation pool through initiatives like the spark venture fund, acceleration of new business models we expect the company to comfortably defend its market leadership position.

In the report we also outline other key growth drivers for company mainly:

- **Mobile data:** Mobile data revenues grew at a CAGR of 36.4% from KES 2.9 billion in FY2010 to KES 14.8 billion in FY2015. The company has been able to grow subscriptions by a CAGR of 35.9% (2010-2015: end of September) to 13.8 million subscriptions. At the end of 1H2016, the company had increased the number of smart devices on the network by 9.1% from 4.1 million (3.9 million smartphones) in FY2015 to 4.8 million (4.1 million smartphones) devices. Usage for the 1H2016 stood at 180MB/Month.
- **MPESA:** Safaricom's M-PESA has been one of the most successful telecom payment platforms in the world. M-PESA registered users and transactions grew by a CAGR (FY2011-FY2015) of 10.6% and 33.9% to 20.7 million and 4,179 Billion respectively. Over the same period, MPESA revenue grew at a CAGR of 29.0% to KES 32.6 billion (20.0% of total revenues).

Based on the forgoing we place a **BUY** recommendation on the stock with a target price of **KES 19.08** providing an upside potential of **16.33%** from the current (03/16/2016) share price level of KES 16.40.

Metric	FY2013A	FY2014A	FY2015A	FY2016F	FY2017F
Net Profit Margin	14.1%	15.9%	19.5%	20.8%	22.4%
EBITDA Margin	39.6%	42.1%	43.6%	45.1%	46.9%
Return on Average Equity (ROaE)	23.0%	26.8%	32.6%	34.6%	37.5%
Return on Average Asset (ROaA)	14.0%	17.5%	21.9%	24.1%	27.9%
Current Ratio	0.7	0.7	0.6	0.7	0.9
EBITDA/Finance Costs	17.3	32.4	52.9	95.2	173.9
EBIT/Finance Costs	9.5	18.7	33.9	63.3	118.7
Debt/Equity	0.25	0.14	0.10	0.03	0.03
Debt/Capital employed	0.16	0.09	0.07	0.02	0.02
Earnings Per Share(KES)	0.44	0.57	0.80	0.96	1.17
Dividend Per Share(KES)	0.31	0.47	0.64	0.77	0.94

GLOSSARY OF TERMS

- ✓ **Mobile Network Operators** – These are mobile service providers that own most (if not all) of the telecom infrastructure (especially the active infrastructure) used for providing wireless communication services.
- ✓ **Radio Spectrum**. This is the range of possible frequencies in the electromagnetic spectrum that can be used for wireless communication.
- ✓ **Addressable Population** - This refers to population aged 15 years and above.
- ✓ **TV white Spaces technology** – This is a technology that makes use of unutilized frequencies in the TV bands.
- ✓ **Over the Top Players** – These are players who make use of operators' infrastructure (mostly the internet) to deliver services to users but without the involvement of operators in the control or distribution of the services.
- ✓ **Exabyte (EB)** - This is a large unit of data equivalent to 1.0 billion gigabytes
- ✓ **Long Term Evolution (LTE)** – This is a fourth generation (4G) wireless broadband technology developed by the Third Generation Partnership Project (3GPP).
- ✓ **Radio Access Network (RAN)** - It's the part of the network that connects users to other parts of the network. It mainly consists of the base station. It's the most capital intensive part of the network. It can account for up to 80.0% of the capital expenditure (CAPEX) according to China Mobile Research Institute.
- ✓ **Cloud RAN(C-RAN)** - It's an emerging architecture in the design of the RAN that is based on the tenet of centralization and virtualization of the some components of the base stations.
- ✓ **Mobile Number Portability (MNP**) - This is a service that allows a user to switch over to another mobile service provider while retaining their existing mobile phone number.
- ✓ **Mobile Virtual Network Operator (MVNO)** – This is an operator who provides mobile services using capacity leased from a mobile network operator.
- ✓ **Minute of Use (MoU**) – This represents the average number of minutes a user makes in one month.
- ✓ **Average Revenue Per User (ARPU)** – This represents the average revenue generated by a user usually on a monthly basis. Its calculated as revenue(can be for a specific revenue line like mobile data or combination of several revenue lines in which case it's called blended ARPU) for a specific period divided by average number of users.
- ✓ **Dumb Pipe** – In mobile data this refers to an operators' network being used just for carriage of OTT services.
- ✓ **Herfindahl-Hirschman Index (HHI)** – It's a measure or an indicator of market concentration or degree of competition.

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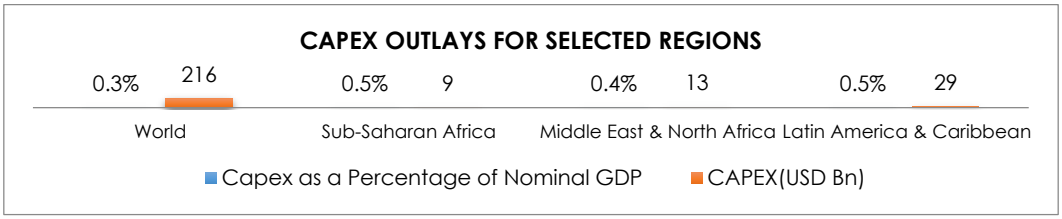
GLOBAL INDUSTRY OVERVIEW

1. Industry Structure

The telecom industry has relatively high barriers to entry. Operators have to invest in technology to meet evolving user demands and have to constantly maintain and upgrade networks to avoid obsolesce. Due to its capital intensive nature, the ownership structure of most mobile network operators (MNOs) tends to have some government or multinational (or both) ownership. The chart below shows typical operator capital expenditures (CAPEX) spends in absolute terms and as a percentage of nominal GDP for selected regions for 2014.



Source: GSMA Intelligence, FIB

In addition, the amount of usable radio-spectrum, the lifeblood of the wireless communication industry, is a finite resource with current demand outstripping supply. This creates "scarcity" in the resource which is more pronounced for MNOs who have to find the right mix of bands that offer extensive coverage and capacity. The scarcity has mainly been artificial due to use of spectrally inefficient technologies (e.g. analogue broadcasting), inefficient spectrum allocation and management systems and underutilization by some entities (mostly government agencies and smaller operators).

Sub 1 GHz bands refers to bands below 1000MHz (e.g. 900,800,700,400MHz)

In some countries the pace of availing more spectrum to MNOs or re-farming (repurposing) spectrum to more efficient technologies has not matched the pace of growth in mobile data traffic. If not addressed, this may lead to congestion particularly in the high demand sub 1GHz bands (valued for offering extensive coverage due to their better propagation characteristics) making spectrum more expensive and inaccessible to new players while degrading the quality of service(QoS) for existing players.

***It's a technology that makes use of unutilized frequencies in the TV band e.g Mawingu Project in Kenya**

Going forward, we are likely to see operators adopt and regulators promote active and passive infrastructure sharing to cut CAPEX costs and alleviate the "scarcity" in spectrum. We also expect increased use of alternative wireless (usually over license exempt spectrum) technologies such as Wi-Fi and TV white spaces technology* and accelerated efforts to avail additional spectrum to MNOs.

Mobile Markets are oligopolistic

Due to current spectrum constraints and CAPEX requirements, mobile markets tend to be oligopolistic where only a few companies, usually 3 or 4, control significant market share. In countries where the number is greater, the market tends to be heavily concentrated on the top 3 or 4 players.

Market Shares controlled by the Top 3 and 4 Operators in Selected Countries

Country	Market Share/No. of Operators	Total No. of Operators
United States	98.8%/4 (83.3%/3)	5*
Nigeria	98.7%/4 (83.2%/3)	6
Brazil	98.7%/4 (80.9%/3)	Over 5
Tanzania	99.1%/4 (94.3%/3)	6
Russia	98.6%/4 (84.3%/3)	Over 8
India	70.1%/4 (58.9%/3)	11
United Kingdom(U.K)	100.0%/4 (86.9%/3)	4
South Africa	99.4%/4 (97.1%/3)	5
China	100.0%/3 (80.4%/2)	3

Source: Respective Country Regulators, FIB:
CDMA subscriptions & MVNO data included where available,*Major Operators

2. Global Sector Players

The global telecom sector is characterized by a relatively high number of multinationals. The table below summarizes the 6 biggest (by subscriptions) telecom operators with significant global presence:

Due to the on-going consolidation these figures are likely to change (or have already changed).

Top 6 Global Operators by Mobile Connections(2Q2014)

Company	Mobile Connections (Mn) 2Q2014/4Q2015	Countries of Operation	Latest FY Group Revenue (USD Bn)
Vodafone Group(U.K)	435.9/461.0	26	2014/15: 62.7
Bharti Airtel Group(India)	287.2/336.2	20	2014/15: 14.7
América Móvil Group(Mexico)	266.9/285.5	25	2015: 51.8
Telefónica Group(Spain)	249.4/247.1	21	2015: 51.4
VimpelCom Group(Netherlands)	218.2/217.4	14	2015: 9.6
Orange Group(France)	184.6/205.3	29	2015: 43.8

Source: GSMA Intelligence Operator ranking (2Q2014), Company Filings, FIB

***We calculate blended mobile Average Revenue per User (ARPU) as mobile revenue for the 12 months ending June 2014 divided by period ending SIM connections as provided by GSMA Intelligence. Our ARPU ranking takes into account only the top 30(by subscriptions) global operators.**

We note that for the same period (year ending 2Q2014) China Mobile was the biggest operator globally in terms of revenue (USD 90.7 billion) and connections (790.6 million). However, in terms of blended mobile average revenue per user (ARPU)* operators from three countries i.e. United States, Japan and South Korea dominate the top 6 ARPU ranking*: Verizon, USA (USD 57.0); NTT Docomo, Japan (USD 47.60); Softbank Group, Japan (USD 46.6); AT&T, USA (USD 43.7); au (KDDI), Japan (USD 34.15) and SK Telecom, South Korea (USD 30.9).

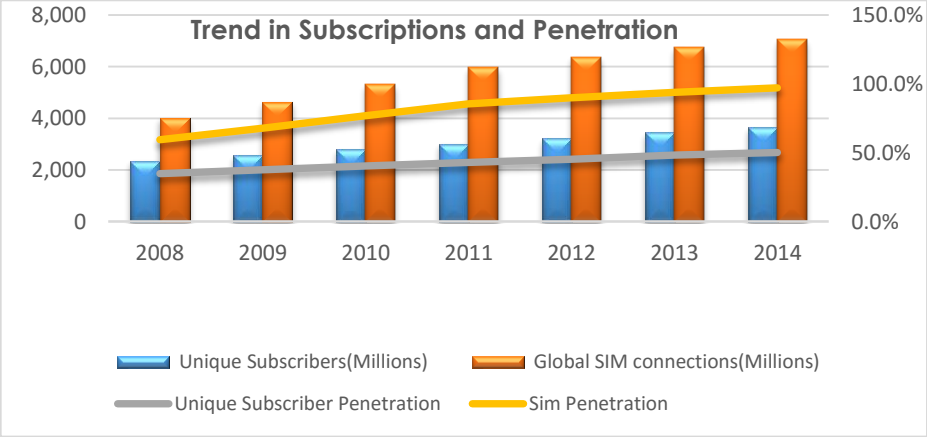
These advanced markets typically have high usage levels due to high levels of disposable incomes, wide 3G and 4G coverage, high smartphone adoption and mobile penetration rates. Operators in these markets have also been better at monetizing mobile data through innovative business and pricing models compared to other markets.

3. Global Sector Trends in Subscriptions

According to GSMA Intelligence, global SIM connections grew at a CAGR of 9.9% in the 2008-2014 period to 7,057 million (7.4 billion including Machine to Machine (M2M) connections), representing a SIM penetration of 97.2% (68.1% of the addressable population). Over the same period, unique subscribers, which represents the estimated number of persons (as opposed to SIM connections) using mobile services, grew at a CAGR of 7.6% to 3,636 million. Global unique subscriber penetration, which provides a more realistic measure of penetration of mobile services based on unique subscribers, stood at 50.0% (132.2% of the addressable population).

Global SIM penetration stood at 97.2% while unique subscriber penetration stood at 50.0%.

Addressable Population refers to population aged 15 years and over.



Source: GSMA Intelligence, FIB; SIM connections exclude M2M connections

Asia Pacific region accounts for 49.0% of the unique subscribers

The Asia Pacific Region: The region accounted for 49.0% (1,775 million) of global unique mobile subscribers at the end of 2014. China and India had 672 million and 468 million unique subscribers respectively for the same period representing 31.0% of the global unique subscribers. Despite taking the biggest share of subscriptions, unique subscriber penetration for the region was still below the global average at 46.0%.

The developed markets have unique subscriber penetration of over 70.0%

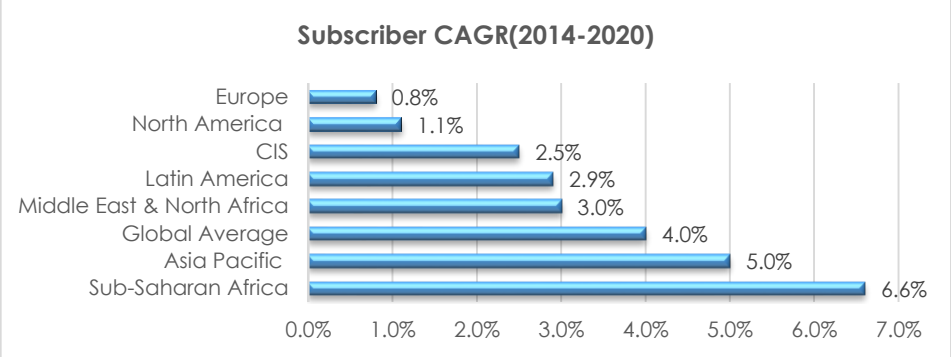
Other Developed Markets: The developed markets (North America, Commonwealth Independent States (CIS) and Europe) had unique penetration levels of 70.0% and above which leaves very little headroom for growth. According to GSMA Intelligence mobile markets tend to saturate at a unique subscriber penetration of about 80.0%. These advanced markets are likely to focus more on the M2M segments (e.g. telematics, smart appliances, smart homes, and smart grids) for growth in new connections as the market for connected devices (Internet of Things) continues to grow.

SSA unique subscriber penetration at 39.0%

Sub Saharan Africa (SSA): Owing to higher poverty levels which limits uptake and use of mobile devices and operators' "unwillingness"* to extend coverage to lower ARPU areas, the SSA region has been underpenetrated in terms of SIM connections and unique subscribers compared to other regions. According to GSMA Intelligence, for the period 2008-2014, unique subscribers grew at a CAGR of 15.6% to 348.0 million. The unique subscriber penetration of 39.0%, is well below the global average.

*Culture/lifestyles and inadequate infrastructure (access to electricity) may prevent operators from extending coverage to some of the areas.

Due to this low penetration level, the region has been experiencing the highest growth rate in subscriptions. This trend will be maintained for the period 2014-2020, as the table below shows, even as growth rate tapers for all regions. However, unique subscriber penetration will remain below the global average and the lowest regionally.



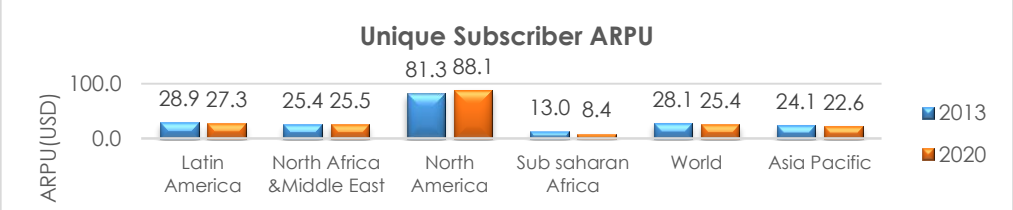
Source: GSMA Intelligence, FIB

SSA region has the lowest ARPU

*Recurring Revenue

The region is also characterized by lower quality subscriptions as evidenced by the low unique subscriber ARPU and compares poorly to other regions. As a result, the high growth in subscriptions has not translated to proportionate growth in revenues. Operator revenue* for the period 2008-2014 grew at a CAGR of 3.2% to USD 38.4 billion, accounting for only 3.3% of the global operator revenues*.

Although economic prospects for the region are expected to improve, income inequalities will remain thereby inhibiting the spending ability of most subscribers. Unique subscriber ARPU is therefore is expected to decline.



Source: GSMA Intelligence, FIB Calculations

Sub Saharan Africa Growth Drivers

Going forward, we expect mobile money and mobile data to be key growth drivers for operators in the SSA region.

According to GSMA Intelligence, unique mobile data penetration, which provides a more realistic estimate of proportion of the population using mobile data, was estimated at 17.0% in 2013 compared to a global unique penetration of 31.0%. In addition, smart device connections, which are key drivers of mobile data traffic, accounted for only 15.0% of the total connections in the region.

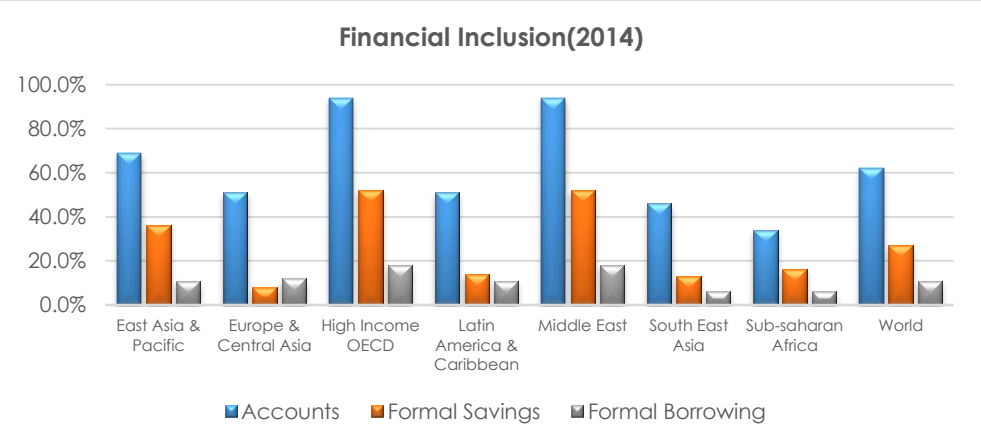
**** Smart devices and connections refer to mobile connections that have advanced multi-media/computing capabilities with a minimum of 3G connectivity (Cisco).**

As MNOs accelerate investments in network coverage and cheaper smart devices are made available, we are likely to see the proportion of smart connections increase to 56.0% by 2020. Meanwhile, unique mobile data penetration will increase to 37.0%.

According to consultancy and research firm Ovum, mobile data revenues for Africa region (including North Africa) will grow faster at a CAGR of 18.2% to USD 25.8 billion (36.2% of mobile retail revenues) over 2014-2020 compared to a CAGR of -0.1% to USD 45.5 billion for voice revenue over the same period.

Mobile money services have been popular in this region than any other region. At the end of 2014, according to GSMA, about 81.0% of all the global mobile money services were in SSA.

The growth opportunity for mobile money in this region is significant as a substantial proportion of the addressable population remains excluded from formal financial services, as the table below shows. The low rate of financial inclusion in SSA presents a gap which mobile financial services can help bridge. We note that a number of operators, in partnerships with financial institutions, have already expanded their mobile money ecosystems to include micro savings and lending and micro-insurance. Mobile money is also competing with cash as a means of payment for goods and services



Accounts include mobile money accounts

Source: Global Findex, FIB

According to Frost and Sullivan, a global consultancy and research firm, mobile money could translate to USD 1,319.8 million in revenues for the region* by 2019 from an estimated USD 655.8 million in 2014. We expect operators in SSA to better capture this growth opportunity compared to Over the Top (OTT) players like Apple, Facebook as most of subscribers are still on non-data capable phones and MNOs can integrate their mobile money services deeper in these economies.

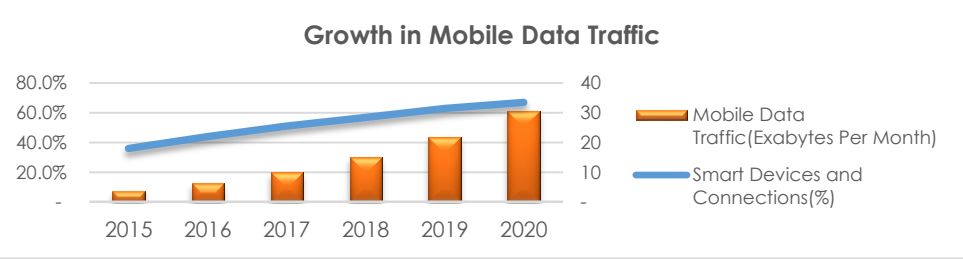
***The revenue estimate is for 6 countries: Kenya, Cote d'IVoire, Ghana, Zimbabwe, Tanzania and Zambia. These countries have recorded relatively higher mobile money uptake compared to other countries in SSA**

KEY GLOBAL THEMES

1. Scaling up Investments in Next Generation Networks (NGN)

1.0 Exabyte is equivalent to 1.0 billion Gigabytes

With increased use of smart devices and data intensive services, global mobile data traffic is expected to grow at a CAGR of 53.0% over 2015-2020 to 30.6 Exabytes (EB) per month. To handle this tremendous growth in traffic, operators will need to scale up coverage and capacity through investments in new cell sites, new network technology (e.g. 4G Long Term Evolution (LTE)) and acquisition of more spectrum.



Source: Cisco Visual Networking Index (VNI) Mobile 2016, FIB

According to GSMA, operator CAPEX for the period 2014-2020 is expected to grow at a CAGR of 2.5% to USD 250 billion, lower than the CAGR of 4.7%(to USD 216 billion) for period 2008-2014. We expect the bulk of this CAPEX to be used in scaling up 3G coverage and for 4G deployments. We expect operators to re-farm existing portfolio of spectrum meant for 2G technologies to these new technologies.

RAN –Radio Access Network. It's the part of network that connects users to other parts of the network. It consists mainly of the base stations.

We also expect operators to benefit from evolution in cellular network designs to more software centric architectures (e.g. single RAN networks, virtualized core networks, Cloud-RAN). This lowers the rate of obsolesce, leads to faster roll-out of new technologies and services and reduces the total cost of ownership (CAPEX and OPEX burden) since most network functions can be defined, scaled and reconfigured/upgraded partly in software.

***The actual cost per MB may vary across different operators depending on cost of the spectrum, CAPEX and OPEX and utilization levels on the network.**

As result of the cost efficiencies and performance improvements the cost per MB for operators is expected to decline significantly as more traffic shifts to 3G/4G networks. Research by the Boston Consulting Group (BCG) shows that 3G and 4G networks can lower the cost per megabyte (MB) by as much as 78.0%* and 90.0%* respectively compared to 2G networks.

We therefore see a positive correlation between these investments and margins. As a result, even though the price of mobile data is expected to decline to stimulate usage in some markets, we expect operators to maintain healthy margins.

2. Consolidation

Operators looking at consolidation to build sufficient scale

With growth in subscriptions and revenues expected to taper, operators are looking at consolidation to build sufficient scale. This will enable economies of scale to be realized, lowering costs and improving (or preserving) margins.

Convergence also driving M&A activity

According to Dealogic, a global mergers and acquisitions (M&A) tracker, 2014 saw 893 deals valued at USD 383.0 billion announced in the global telecoms sector. This was the highest full year value since 2006(USD 392.2 billion). A close scrutiny of the deals reveals that besides building scale, convergence is also a key driver to consolidate. This enables operators to augment their portfolio of services which reduces churn in addition to increasing revenues.

We expect smaller and "unconverged" operators to find it increasingly difficult to compete leading to further consolidation. Most consolidation efforts will likely be in the highly fragmented European telecom sector but we

also see a potential increase in Sub-Saharan Africa targeted M&A activity especially in countries with more than 4 MNOs.

3. Accelerating New Business Models

Increased competition, regulatory intervention and rise of OTT players have strained the legacy telecom business model. In reaction to this development, we note that there has been an increased focus on verticals such as financial services, governments, healthcare, retail sector, media and agriculture as the next growth frontier.

Operators building new business models

Operators are leveraging on their assets, processes and capabilities to build new business models from these verticals. A number of operators such as Safaricom in Kenya have already built successful businesses from these verticals.

To better tap into these opportunities or capture a bigger part of the value chain operators have either made strategic acquisitions or partnerships to enhance their capabilities:

- Verizon's acquisition of American Online (AOL) and Telefonica's acquisition of Mobclix (now known as Axonix) Ad platform from Velti seeks to tap into digital advertising.
- MTN and Millicom's acquisition of minority stakes in Africa Internet Holding, the parent company of online retailer Jumia and Safaricom's investment in Sendy, an on-demand delivery start-up seeks to tap opportunities in e/m-commerce.
- Safaricom's partnership with Seven Seas Technologies, a Kenyan based ICT multinational seeks to tap into opportunities in healthcare, governments, education and agriculture.

According to STL Partners, a global consultancy and strategy firm, operators can unlock at least USD 375.0 billion annually from these new business models. We see an uphill task for telecoms in unlocking this revenue in some of these verticals as they're already dominated by OTT players.

4. Regulatory Reforms

Emerging issues requiring regulatory intervention

The rise of OTT players and acceleration of new business models has called for change in regulatory framework. Some of the emerging issues requiring regulatory intervention include:

1) Tiered internet access model i.e. preferential treatment of internet traffic especially over the last mile. This has raised the issue of whether the operators should be allowed to "augment" the working of the internet with new business models such as paid prioritization (Net Neutrality).
2) OTT communication.
   a) Security. Encryption by some OTT providers has made it harder for authorities to carry out lawful interception.
   b) Impact on operator revenues. Operators have raised the issue of OTT players "freeloading" on their networks.
   c) As OTT players provide similar services to telecoms, the issue of whether they should be regulated has been raised.
3) Privacy. As operators venture into new platform services such as advertising, concerns on how operators use customer data have been raised.

In addition, the wave of M&A activity in certain regions like Europe is likely to raise anti-trust issues. In light of this, it'll be interesting to see whether regulators will give some regulatory leeway for consolidation to take place.

KENYA TELECOM SECTOR

Kenya Telecom sector transitions from monopoly to competition.

Kenya's telecom sector transitioned from monopoly to competition following liberalization in 2000. Prior to that, the Kenya Posts and Telecommunication Corporation (defunct) was the sole provider of telecommunication services in Kenya.

The Communication Authority of Kenya (CA) is mandated with the development and regulation of the information and communication sector in Kenya. This includes postal and courier, broadcasting, multimedia, e-commerce and telecommunication sub-sectors. CA is thus a converged regulator.

Important Regulatory Developments

To address the challenges of convergence and encourage competition and innovation, the CA (then known as Communication Commission of Kenya (CCK)) adopted a Unified Licensing Framework (ULF) in 2008 which provides for a technology and service neutral licensing regime. The ULF provides for a relatively future proof licensing regime that has lowered the barriers to entry.

The CA has tried to enhance competition

In an attempt to enhance competition the CA introduced mobile number portability (MNP) and mediated the opening up of mobile money agency network. So far both have had minimal impact on the competition landscape.

The CA has also been more open to spectrum use by allowing MNOs to re-farm spectrum meant for 2G services (the 900MHz and 1800MHz) to 3G and 4G LTE.

Recent amendments to the Kenya Information and Communication Act (KICA) harmonized competition regulation in the sector with that of other sectors. Notably for a provider to be declared dominant there must be proof of abuse of dominance for remedies to be implemented. The CA also has to consult with the Competition Authority of Kenya (CAK) on dominance related matters.

Market Structure

The ULF shifted licensing to a horizontal approach

Under the ULF, the service is licensed separately from the infrastructure/technology (horizontal approach). The ULF thus provides for only 3 broad categories with the first 2 being the main ones:

- Network Facilities (Infrastructure based) Provider (NFP); Includes NFP Tier 1, 2 & 3 providers, International Gateway Providers, Sub marine cable landing.
- Non-Infrastructure based service providers: Includes Content and Application Service Providers.
- Ancillary Sector Players: Includes Terminal Equipment Vendors, Contractors, Business Process Outsourcing.

Market Players

The mobile market is characterized by 3 MNOs: Safaricom, Airtel Kenya and Orange/Helios and 3 mobile virtual network operators(MVNOs); Finserve (Equitel), Zion cell and Mobile Pay (runs Tangaza Money service) which are all hosted on Airtel Kenya's network. The table below summarizes 3Q2015 key market indicators for the 3 mobile network operators and Finserve (Equitel).

KEY MARKET INDICATORS (3Q2015)				
	Safaricom	Airtel	Orange	Finserve
Subscriptions				
Subscriptions	25,095,726	7,214156	4,469456	1,085,869
Market Share	66.3%	19.1%	11.8%	2.9%
HHI*		4,908		
Voice				
MoU	111.6	82.5	64.5	8.6
Market Share(Minutes)	76.0%	16.2%	7.6%	0.2%
HHI		6,096		
Mobile Data				
Subscriptions	13,800,000	3,700,000	2,800,000	1,000,000
Market Share(Average subscriptions)	64.8%	17.4%	13.4%	4.7%
HHI		4,694		
SMS				
Market Share(No. of SMS)	89.6%	8.7%	1.6%	0.1%
HHI		8,113		
Mobile Money				
Subscriptions	22,127,622	3,114,956	191,300	1,085,869
Market Share	76.9%	10.8%	0.7%	3.8%
HHI		6,084		
Fixed Data*				
Subscriptions	10,965	N/A	2,152	N/A
Market Share	9.2%		1.8%	
HHI		3,336**		

Source: FIB, Communication Authority of Kenya(CA); ** HHI calculated using market shares for the first 10 companies ; MoU calculated using average subscriptions for the quarter; *2Q2015

The mobile market is a highly concentrated market

The competition landscape in all retail mobile segments is skewed in favour of Safaricom. Under U.S competition standards, all retail mobile segments would be classified as highly concentrated as evidenced by a Herfindahl Hirshman Index (HHI) of more than 1800. This coupled with the huge disparity in market shares (over 45.0%) between Safaricom and the competition indicates a lack of effective competition.

We opine that the competition alone cannot be relied upon to advance market efficiency. We see a need for greater regulatory oversight to thwart off any abuse of market leadership position and to increase the competitiveness of smaller players. The Initial proposal for accounting separation could help identify uncompetitive practices such as cross subsidization while mandatory infrastructure sharing could increase competiveness of smaller players without prejudicing dominant players.

KEY INDUSTRY THEMES

1. Is the Voice Market on the Verge of Maturity?

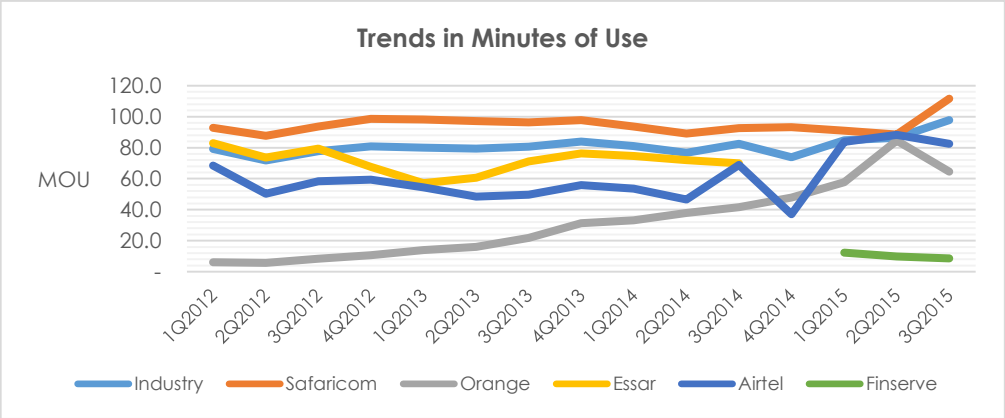
New subscribers will have low MoU

On a unique subscriber perspective, according to Analysys Mason, penetration rate in Kenya is estimated at about 50.0%. This presents some headroom for growth in subscriptions. However, the quality (in terms of MoU) of new unique subscribers will likely be low. We attribute this to expansion to areas with low spending on mobile services and higher affinity for OTT communication platforms like Whatsapp.

Although we expect growth in multiple SIM ownership preferences will likely be for non-voice services such as such as 4G LTE and cheaper mobile money services. We therefore expect low MoU from these connections. This can be seen for Finserve (focuses on mobile money) which has recorded high growth in subscriptions without proportionate growth in voice minutes leading to a decline in its MoU.

Due to reasons discussed above, industry MoU has been flat for the better part and Orange is the only player that has consistently grown its MoU, mostly through price undercutting.

Industry MoU has been flat for th better part



Source: FIB, CA

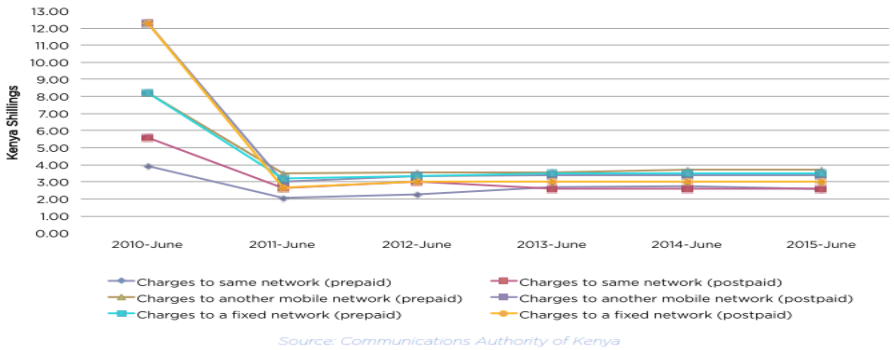
In light of this, we are likely to see increased promotional activity on voice to increase usage. Some operators like Airtel Kenya have implemented tariff plans that bundle data and voice but heavily discount the latter. Although these strategies may grow MoU, as seen for Safaricom in the 3Q2015, the effective yield per minute is lower. We therefore don't expect proportionate growth in voice revenues.

Operator strategies may grow MoU but voice revenues will not grow proportionately.

…Operators on the Defensive

As the diagram below shows, voice tariffs have remained almost unchanged since June 2011. Benefits of recent cuts in mobile termination rates (MTR) have not been passed to customers and have passed without any tariff wars. This was to protect voice revenues.

Average Voice Tariff Trends for the past 5 Years



We opine that absent of any regulatory intervention, significant downward revisions in voice tariffs such as those seen between June 2009 and June 2011(price war period) can only be stimulated by greater adoption of more efficient 3G networks (& 4G Voice Over LTE*), infrastructure sharing and improvements in cellular network designs as highlighted in the global overview. These shifts may lower the cost of offering voice services, which makes it feasible, from a margins perspective, to lower voice tariffs. On the other hand, 3G/4G adoption may lead to high uptake of OTT VoIP which may force operators to lower voice tariffs.

***Voice over LTE (VoLTE) is a standard for delivering voice services over LTE networks. Its carrier grade VoIP.**

Both scenarios require ubiquity in 3G & 4G population coverage and adoption by users, which is more of a long term proposition and significant investments in network improvements. As such voice tariffs are likely to be maintained at current levels in the short to medium term.

Voice tariffs to be maintained at current levels in the shrot to medium term

2. Focus Shifts to Mobile Data…but is monetization any better?

Despite more resources being allocated to mobile data, voice remains the major revenue contributor in most markets. We see a need for more innovation in monetization strategies for mobile data.

Operators need to shift from a pure dumb pipe model.

Operators will need to shift from a pure "dumb pipe" model i.e. just transport providers for OTT services and start offering differentiated, value added services to retail customers, businesses and governments. We are cautiously optimistic that there is a shift in strategy with these "bigger and faster" networks.

A case in point is Safaricom's home broadband proposition via its 3G/4G network as an alternative to Fibre to the Home (FTTH). Orange Kenya offers a similar proposition under its dual play "Home talk" and "Biashara Talk" packages targeting the residential and SME segments respectively.

Going forward, we expect more services such as video on demand and cloud based services (such as Software as a Service) to be bundled under these initiatives.

Operators have shifted to tiered, usage based data plans

In terms of pricing, most MNOs have shifted to tiered, usage based data plans. Under this pricing model, operators offer differentiated pricing depending on the device type and validity period, as the table below shows. All plans are made available to users regardless of the network type i.e. no differentiated 2G, 3G and 4G plans.

Mobile Data Plans

Company	Bundle	Validity(Days)	Device	Price(KES)
Orange Kenya	50GB(Unlimited)*	30	Orange FlyBox Router**	4,000
	50GB	90	Phone/USB Modem	6,750
	10GB(Unlimited)*	7	USB Modem	990
Safaricom	30GB	30	The Big Box(Set Top Box)**	6,000
	30GB	90	Phone/USB Modem	9,000
	7.5GB	30	Phone/USB Modem	2,000
	6.0GB	90	Phone/USB Modem	3,000
Airtel Kenya	20GB(Unlimited)*	30	Phone/USB Modem	3,000
	30GB	90	Phone/USB Modem	6,000

Source: Company websites: *Fair Usage Policies Apply(Mostly Speed Caps); ** For Home and business broadband solutions

Since the cost per MB declines as more traffic shifts to 3G/4G network, we opine that network differentiation can be offered which would for instance provide differentiated pricing (e.g. higher data allowances to cater for heavy data users) on the 4G/LTE network. Such data plans can subsidized creating an incentive for 4G/LTE uptake.

There is a willingness to experiment with different pricing models to complement tiered usage based plans. A case in point is Airtel Kenya's "UnlimiNet tariff" which bundles unlimited access to several social sites such as Facebook, Gmail, Whatsapp, Twitter and Instagram even when the allowance runs out.

We expect more application or service specific plans

As MNOs venture into content provision, we expect to see more application or service specific plans that align pricing with certain services or applications such as media (TV, Movies & Music) consumption which would otherwise be expensive under tiered, usage based plans. We also expect operators to use such pricing models as a strategy against competing OTT content providers.

With a more lenient regulatory framework (no net neutrality issues) coupled with smart capabilities(e.g. Big Data Analytics) built into networks, we expect Kenyan operators to come up with innovative strategies, both in pricing and service provision that will further monetize mobile data. This will re-align value to mobile data rather than voice and SMS thus re-affirming the business case for NGNs.

3. Mobile Money…Moving Beyond Money Transfer

Mobile Money widely adopted in Kenya.

***FY2015 - year ending March 31st**

****These are low value transactions (average of KES 2,589 in FY2015).**

Mobile money, compared to other payment methods, has been widely adopted in Kenya as evidenced by the high number of transactions. For the FY2015*, according to data from the Central Bank of Kenya(CBK), mobile money registered 957.5 million** transactions compared to 2.7 million on the Kenya Electronic and Payments System (KEPSS)/Real time Gross System (RTGS) and 246.2 million on cards. We expect even greater adoption as the ecosystem continues to evolve to include micro-lending and savings, bulk disbursements, bill payments and investing in government securities.

Share of mobile money in total payments remains low.

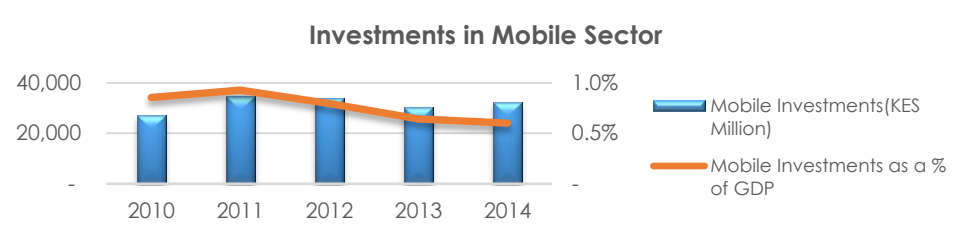
This coupled with the move by some of the players to promote their mobile money platforms as a Business to Business (B-to-B) payment solution will help operators capture a bigger share of payments space. For the FY2015 mobile money only accounted for 8.2% of the total payments, which was higher than the value done on cards (3.8%) but lower compared to 88.0% for KEPSS. Despite Safaricom controlling a huge part of the mobile money ecosystem in Kenya, the segment continues to attract new players.

4. Scaling up Investments in Network Capacity and Coverage

Improvement in national and international ICT infrastructure has partly contributed to reduction in total cost of owning a smart device.

Investments made in improving national (e.g. national fibre backbone network) and international (e.g. Submarine Fibre optic cables) infrastructure have increased backhaul capacity and replaced expensive satellite bandwidth with cheaper fibre bandwidth resulting in significant cost savings to operators. This has been passed to consumers in the form of lower mobile data prices. With 3G smartphones retailing for as low as KES 4,000(USD 40.0) and cost per MB at a low of KES 0.08, the total cost of owning a smart device has declined significantly. Consequently, operators are accelerating investments in NGNs to further promote the uptake of both fixed and mobile data.

The chart below shows investments made in the mobile segment in the past 5 years. The period between 2011 and 2013 saw a consistent decline in investments as operators cut back on investments due lower profitability from the price wars and resulted in infrastructure sharing or leaseback agreements.



Source: CA, FIB

Safaricom currently has the best coverage

Currently, Safaricom has the best coverage with a 2G population coverage of 92.0% and a 3G population coverage of 73.0%. The company has consistently invested in network improvements with an average annual spend of KES 25.2 billion (average CAPEX intensity (CAPEX/Revenue) of 25.3%) over our review period (FY2008-FY2015). For the FY2016, we expect the company to inject KES 33.1 billion in network improvements. We expect this to go towards improving 2G and 3G population coverage to 100.0% and 80.0% respectively, deploying the LTE-Advanced network and rolling out the fibre backbone network.

Airtel to invest KES 19.0 billion

In 2015, Airtel Kenya announced a KES 19.0 billion investment spread over 3 years. Part of the investments will be spent on further network upgrades in readiness for 4G LTE. We note that Airtel has shifted from building to leasing most of its infrastructure which lowers CAPEX & OPEX costs and allows it to focus on service delivery and strategy.

Orange retires CDMA/EVDO network in favour of GSM technology

In 2014, Orange Kenya announced a KES 2.5 billion investment to expand its 3G network and the national fibre optic backbone network (on behalf of the government). Expansion of the company's 3G GSM network and investment in 4G/LTE are expected to make up for the shutdown of its fixed wireless (CDMA/EVDO) network.

Investments to be made in acquiring spectrum

***Orange had 2 x 5MHz (800MHz) for the CDMA network**

Further investments will be made in acquiring spectrum for 4G LTE. With the completion of the digital TV migration and shutdown of the CDMA network* a total of 2x60MHz of spectrum on the 700 & 800MHz will be available to MNOs for 4G LTE. Following a proposal for equal allocation on the 800MHz (2 x30MHz) each of 3 MNOs will have 2x10MHz. At the time of releasing this report negotiations were on-going for the pricing on both bands, capacity sharing obligations and distribution of the remaining 2 x30MHz on the 700MHz.

We expect that these investments in network improvements for the 3 MNOs will be a catalyst for new subscriptions as the importance of mobile and fixed data grows and will serve to support the next generation of telecom services.

5. Increased M&A Activity…Will Helios Slay the Giant?

The past 2 years has seen increased M&A activity with the acquisition of Essar (Yu mobile) by Safaricom and Airtel Kenya, acquisition of a majority stake in Kenya Data networks by Liquid Telecom and acquisition of Access Kenya by Dimension Data.

***It was supposed to be 70.0% but 10.0% was offered to the government for not exercising its pre-emptive rights.**

Recently, Helios Investment Partners, a London based, African focused private equity (PE) Fund announced intentions to acquire France Orange's 60.0%* stake in Telkom Kenya. The fund has several investments in Kenya in various sectors including energy (Vivo Energy), telecoms (Wananchi Group) and technology/Financial services (Interswitch East Africa). The fund also has a majority stake in Helios Towers Africa, a tower leasing company, operating in several countries. This Africa-focused investment strategy gives the fund ample insights in how most African markets work. We believe this is a key differentiator between the former owners and Helios. We expect to see more innovations that resonate with the local market.

In terms of strategy, we expect the company to focus on data (mobile & fixed) and mobile money, which are the only areas we see as having long term growth prospects.

Orange has crucial assets in data (including investments in most Submarine cables to Kenya) at its disposal. With some innovation, Orange/Helios can offer an unrivalled data offering in the retail segment. Also, with 4G LTE being an area of interest for NFP tier 2 operators looking to capitalize on fixed-mobile convergence, we may see Orange offering wholesale access to these players. On mobile money, we expect the company to revamp the Orange money service. Interestingly, Orange money is powered by Equity Bank, a long time investment partner. With Equity Bank's CEO indicating a possible "deeper partnership" once the deal is concluded, we could see Equity Bank launch MVNO operations on Orange and/or a deeper integration of the two mobile money service.

We are cautiously optimistic that Helios will bring some much needed competition in the Kenya telecom sector. However, the task of dethroning Safaricom is a monumental one and unlikely to happen soon.

KEY INDUSTRY GROWTH DRIVERS

1. Increased Subscriber Growth

As alluded to earlier, growth in subscriptions will be driven mainly by network expansion to new virgin areas resulting in new unique subscribers and growth in multiple SIM ownership. For the FY2016 (year ending 31st March), we expect a 15.0% growth in industry SIM connections to 40.0 million, representing a SIM penetration of 84.5%.

2. Favorable Demographics

Research shows that the adoption of technologies and more so internet based technologies is dependent on demographics such as age, literacy levels, income levels and urbanization.

Favourable demographics to drive spending on digital services.

About 46.0% of Kenya's population, estimated at 45.6 million, is aged between 15-44 years. Age usually has an inverse relationship with technology adoption i.e. the younger the population, the greater the rate of adoption. This coupled with fairly good literacy levels (about 70.0% among the addressable population) and improving economic prospects should promote further spending on digital services.

3. Mobile Data

Internet access in Kenya is predominantly mobile based.

Internet access in Kenya is predominantly mobile based with mobile subscriptions accounting for 99.5% (3Q2015) of total internet subscriptions. Thus MNOs are some of the biggest internet Service Providers. Going forward, industry mobile data revenue will be driven by the following factors:

a) Growth in Mobile Data Subscriptions

Mobile data subscriptions have shown impressive growth in Kenya, registering a CAGR of 46.2% (2009-2015: year ended 30th September) to 21.3 million. We see more headroom for growth in mobile data subscriptions. We forecast industry mobile data subscriptions for the FY2016 (ended March 31st) to 24.0 million.

b) Increasing the Proportion of Smart Devices

As earlier mentioned, mobile data traffic is driven by use of smart devices such as smartphones, tablets, and dongles. According to the Cisco VNI 2016(Mobile), the global average usage on a smartphone stood at 929MB/month, 40x more traffic than a basic feature phone (23MB/month).

The availability of these smart devices to a limited number of subscribers coupled with demographic differences results to a common occurrence in mobile data networks where a small proportion of subscribers account for most of the mobile data traffic. We note that at one point, while making the case against unlimited plans, Safaricom management indicated that 1.0% of users accounted for 70.0% of the traffic. Globally, in 2015, smart connections accounted for 36.0% of the connections but generated 89.0% of the traffic.

The challenge for operators in Kenya is to increase the proportion of smart connections on their networks by availing smart devices at affordable prices. Most devices in Kenya are sold through "Pay As You Go" schemes with subsidization only done through promotional offers. This limits the uptake of devices. Partnerships with Original Equipment Manufacturers (OEMs) and introduction of financing options will boost the uptake of smart devices.

c) Changing Consumer Usage Patterns

The same report from Cisco notes that mobile video content is a key driver of mobile data traffic and accounted for 55.0% of total global mobile data traffic in 2015.

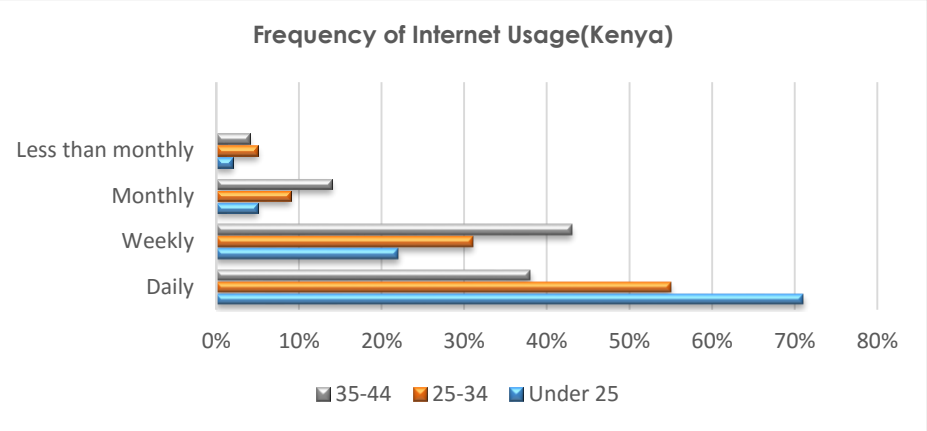
Kenya smartphone users have a bias towards less data intensive content consumption

Usage patterns among Kenyan smartphone users show bias towards less data intensive content consumption. According to the Google Consumer Barometer, only 8.0% of smartphone users in Kenya watch online videos daily (51.0% never watch online videos).

We attribute the bias to the high cost associated with data intensive content consumption. A reduction in the unit cost of data (through smart pricing), will likely shift consumer behavior towards more data intensive content consumption.

d) Favourable Demographics…

The chart below shows that age has an inverse relationship with the frequency of internet usage in Kenya.



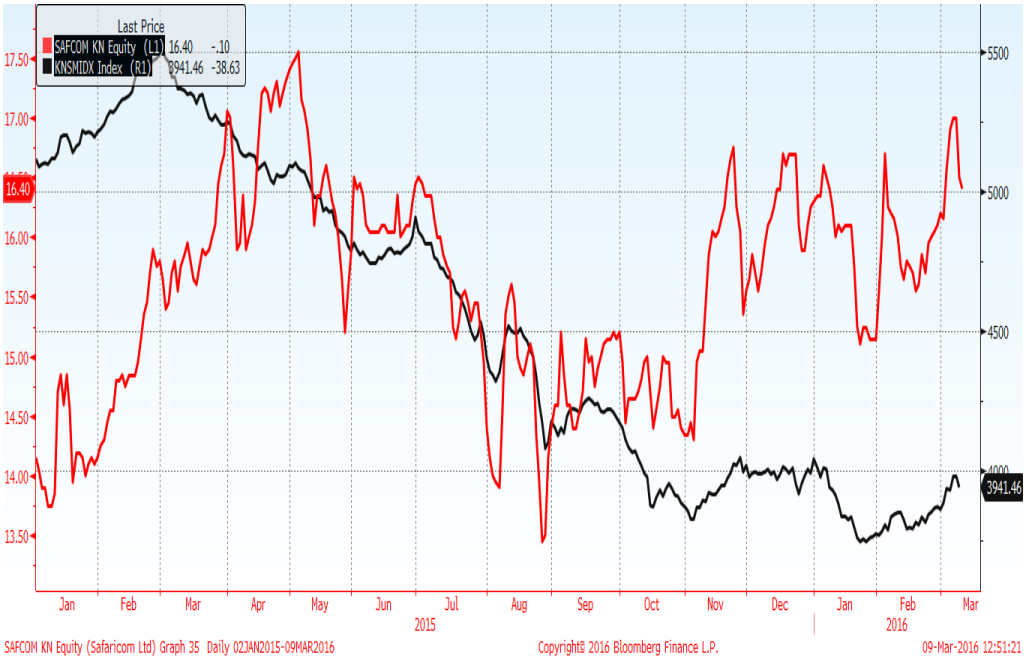
Source: Google consumer Barometer

The under 25 year's group have a higher rate of internet usage. As the purchasing power of this age group is likely to be inferior operators will have to device innovate pricing strategies to stimulate usage.

SAFARICOM LIMITED

Recommendation: BUY

Bloomberg Ticker: SCOM



Share Statistics

Fair Value(KES)	**19.08**
Price(KES)- 03/16/2016	16.40
Issued Shares(m)	40,000
Market Cap(KES Bn)	657.1
Market Cap(USD Mn)	6,474
Year End	31st March
Free Float	25.1%

Shareholder Information(2015)

Name of Shareholder	% Shareholding
VODAFONE KENYA LIMITED	39.9%
CABINET SECRETARY — THE TREASURY	35.0%
STANDARD CHARTERED NOMINEES A/C KE002112	1.1%
STANDARD CHARTERED NOMINEES NON-RES. AC 9069	0.7%
STANDARD CHARTERED NOMINEES NON-RES. AC 9835	0.6%
STANDARD CHARTERED NOMINEES NON-RES. AC 9318	0.5%
STANDARD CHARTERED NOMINEES NON RES. A/C KE05311	0.5%
STANDARD CHARTERED NOMINEES A/C KE11916	0.5%
STANDARD CHARTERED NOMINEES NON-RES. A/C KE10085	0.5%
STANDARD CHARTERED NOMINEES A/C 9853	0.3%
OTHERS	20.4%
TOTAL	100.0%

INVESTMENT SUMMARY

We initiate coverage on Safaricom limited with a **BUY** recommendation on the stock, with a target price of KES 19.08, providing a 16.33% upside potential from the current(03/16/2016) share price level of KES 16.40

The stock is trading at a projected forward multiple of 17.2 (P/E) and 7.88 (EV/EBITDA). Our comparable analysis reveals that the company trades at higher multiples than most of its African peers. This is justifiable given its hugely successful mobile money and overall better utilization of assets and capital employed as indicated by higher return on assets and capital employed.

We are optimistic about the sustained growth of the company. With limited scope for future Voice growth, we expect mobile money and mobile data to be key growth drivers for the company while leveraging off its market leadership position.

KEY COMPANY DATA	FY2015	FY2016 Estimates	Growth %
Total SIM Connections(Subscriptions)	23,350,000	26,431,669	13.2%
MPESA Registered Users	20,650,000	23,304,097	12.9%
30 Day MPESA Active Users	13,860,000	16,955,476	22.3%
Mobile Data Subscriptions	12,147,353	15,577,849	28.2%

Investment Snapshot

Metric	FY2015	FY2016 Estimates	Growth %
Return on Average Equity(ROaE)	32.6%	34.6%	6.1%
EBITDA Margin	43.6%	45.1%	3.2%
Current Ratio	62.4%	70.7%	10.8%
EBITDA/Finance Costs	52.9	95.2	80.0%
Debt/Equity	0.10	0.03	-72.3%
Earnings Per Share(EPS)	0.80	0.94	20.1%
Dividend Per Share(DPS)	0.64	0.77	20.1%

BRIEF HISTORY

Safaricom Ltd started as a department of the Kenya Posts Telecommunications Corporation. It launched operations in 1993 based on the analogue Extended Total Access Communication system (ETACS) network but upgraded to GSM in 1996.

It was a state corporation by virtue of 60.0% stake held by the Government of Kenya (GoK). Until 20 December 2007, the GoK shares were held by Telkom Kenya Limited, which was a state corporation under the State Corporations Act.

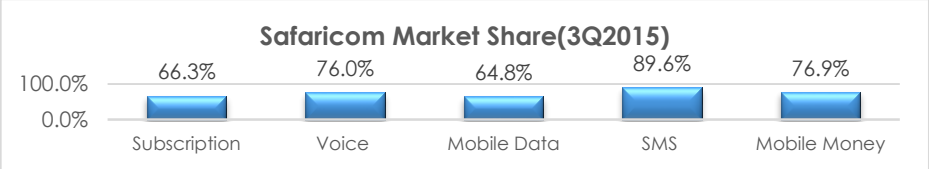
Following the offer and sale of 25% of the issued shares in Safaricom held by the GoK to the public in March 2008, the GoK ceased to have a controlling interest in Safaricom under the State Corporations Act.

SAFARICOM GROWTH DRIVERS

1. Market Leadership

Safaricom maintains market leadership in all retail mobile segments

Safaricom has consistently maintained market leadership in all retail mobile segments. We attribute this to the company's superior network spend and a deep understanding of the local market. The company has been able to keep up with global trends while delivering locally relevant innovations such as M-PESA, Okoa Jahazi (emergency top ups) and low tier top up cards. The competition which mostly consists of multinationals has failed to implement a "think global but act local "approach which has seen some adopt unsustainable business models in the local market.



Source: Company Filings, FIB

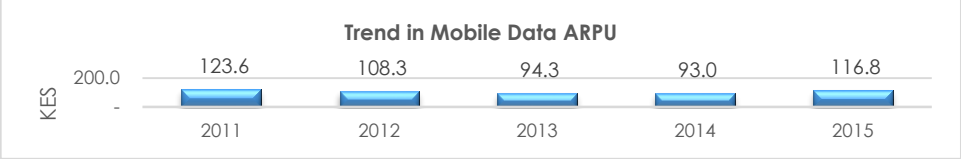
Innovations like MPESA have massive network effects which lock in customers thereby reducing churn rate. It's estimated that MPESA users are 10-30.0% stickier i.e. less likely to churn than non-users.

With the accelerated investments in network improvement, diversified product offering, the company's efforts to tap into a wider innovation pool through initiatives like the spark venture fund and acceleration of new business models we expect the company to comfortably defend its market leadership position.

2. Mobile Data

Mobile data revenues grew at a CAGR of 36.4% from KES 2.9 billion in FY2010 to KES 14.8 billion in FY2015. For the FY2015, mobile data revenues accounted for only 9.1% of total revenues but contributed 30.0% to the absolute growth in the top line.

The growth in mobile data is attributed to proliferation of cheap smart devices, increase in network coverage and affordable pricing of data through bundling. The company has been able to grow subscriptions by a CAGR of 35.9% (2010-2015: end of September) to 13.8 million subscriptions. However, mobile data ARPU(30 day active users) for the better part of our review period has been on a declining trend owing to the low quality(in terms of ARPU) of new mobile data subscriptions.



Source: FIB, Company Filings

Going forward we expect mobile data revenue to be driven by the following factors:

a) Growth in Subscriptions

We expect Safaricom to grow mobile data subscriptions by 28.2% (y-o-y) to 15.6 million subscriptions for the FY2016. We attribute the growth in subscriptions to the on-going "Best Network in Kenya" initiative.

b) Increasing the Proportion of Smart Connections

At the end of 1H2016, the company had increased the number of smart devices on the network by 9.1% from 4.1 million (3.9 million smartphones) in FY2015 to 4.8 million (4.1 million smartphones) devices. On average, assuming one device represents one subscription, these smart devices represented 36.0% of the average 30 day active mobile data subscriptions for the 1H2016(12.6 million subscriptions).

Smart devices consumed 439.6MB/month of mobile data compared to 31.2MB/month for non-smart devices in the 1H2016.

Over the same period, according to management, average usage per active user stood at 180MB/month. Based on this usage and assuming these smart devices account for 89.0%* of the mobile data traffic, we estimate that for the 1H2016, on average, smart connections consumed about 439.6MB/month of mobile data compared to 31.2MB/month for a non-smart connection. This usage, however, even among smart device users, is lower than the global average of 0.6GB/Month. This also confirms that most smart device users are not data intensive.

***This ratio represents the global proportion of smart device mobile traffic to total mobile data traffic**

To increase the proportion of smart devices, the company has partnered with OEMs to provide 3G (such as the Neon smartphone) and 4G (such as the Huawei Y550, Alcatel Onetouch Pop 2) smartphones at prices below USD 50.0 and USD 120.0 respectively. We also expect other device vendors to complement Safaricom's efforts. The company also introduced a financing option via the M-SHWARI platform which should further improve uptake of smart devices.

This coupled with improving 3G/4G network coverage and smart pricing of data should stimulate usage and widen the mobile data ARPU. Assuming usage for smart and non-smart devices, yield per MB (KES 0.67) and average subscriptions remain at 1H2016 level, increasing the number of smart devices to 6.0 million (management guidance, 42.8% of average 30 day active users) would lift the company's mobile data ARPU and revenues, over a 6 months period, by 14.4% from KES 121.9 and KES 9.2 billion to KES 138.3 and KES 10.5 billion respectively.

Ceteris paribus increasing the number of smart connections to 6.0 million can widen mobile data ARPU by 14.4%.

Riding on these growth drivers, we expect mobile data revenue to grow at a slower rate of 45.4% to KES 21.6 billion for the FY2016. We attribute the lower growth rate to a lower yield per MB due to an in–bundle tariff reduction introduced in 1H2016.

3. M-PESA

Safaricom's M-PESA has been one of the most successful telecom payment platforms in the world. Its success has been on the back of high formal financial seclusion, a conducive regulatory regime, ease of usage and increased penetration of mobile services. M-PESA registered users and transactions grew by a CAGR (FY2011-FY2015) of 10.6% and 33.9% to 20.7 million and 4,179 Billion respectively. Over the same period, Mpesa revenue grew at a CAGR of 29.0% to KES 32.6 billion (20.0% of total revenues).

For our analysis, we breakdown M-PESA into three platform services:

- M-PESA as a money transfer platform
- M-PESA as a micro lending and savings platform
- M-PESA as a goods and service payments platform

M-PESA as a Money Transfer Platform

M-PESA initially started as a money transfer service. Person to person (P-to-P) transfers have grown at a CAGR (2011-2015) of 27.2% to KES 1,151 billion representing 31.6% of the total transactions done on the MPESA platform. According to Safaricom, 65.0% of all P-to-P transactions are conducted within the KES 10 to 1500 band. The company earns, on average, a transaction fee of 1.1% of the transaction value from these P-to-P transactions. For the FY2015, this translates to KES 12.7 billion in revenue. In terms of margins, we see this particular type of transaction as lucrative since no agent commissions are paid out.

The money transfer service continues to evolve with the introduction of the international money transfer service (IMT). The IMT service enables cross border money transfer (both inward and outward remittances) through IMT partners who include money transfer operators, MTO (cash to mobile) such as money gram, Skrill, and telecom operators (mobile to mobile) such as MTN and Vodacom Tanzania. The partnership with MTOs allows remittances even in countries where mobile money has been unsuccessful or absent.

***SSA average cost of mobile remittances (GSMA)**

Mobile remittances, despite being cheaper (4.0%* compared to average SSA remittance cost of 9.75% (2Q2015)) have recorded slow uptake mostly due to regulatory and operational challenges. The World Bank estimates that only 1.0% of global remittances are channeled via mobile. We don't see the IMT service as a major revenue stream for the company in the short to medium term. Assuming an unrealistic market share of 10.0% to total remittances to and from Kenya (USD 1.8 billion), a yield of 4.0%, the IMT service would have contributed KES 676.8 million or 2.1% of MPESA revenues for the FY2015.

M-PESA as a Micro Lending and Savings Platform

M-PESA currently enables micro lending and saving through partnerships with financial institutions. Two of these services are:

1) **M-SHWARI**: This is a partnership between Safaricom and Commercial Bank of Africa (CBA). As at the end of the 1H2016, M-SHWARI had
    - 7.1 million active users with 3.3 million 30 day active users
    - KES 5.5 billion in deposit. Interest is paid at a rate of 5.0% per annum.
    - KES 6.9 billion on loan (Non-Performing loans (NPL) at 1.6%). A facilitation fee is levied at a rate of 7.5% per month.

2) **KCB-MPESA Account**: This service was launched in March 2015 and is a partnership between KCB Group (Kenya's largest bank by asset base) and Safaricom. As at the end of 1H2016, this service had
    - 2.7 million active users with 30 day active customers at 1.6 million
    - KES 0.5 billion on deposit
    - KES 2.5 billion on loan. Loans are offered on 30 day 90 day and 180 day durations and attract interest at a rate of 6.0%, 5.0% and 4.0% per month respectively.

The company shares interest from loans at a ratio of 70:30 and 80:20 with CBA and KCB Group respectively with the company's share being lower since the financial institutions bear all the credit risk(i.e. NPLs do not affect Safaricom's share of interest from loans).

KCB MPESA account and MSHWARI contributed an estimated 3.3% to MPESA revenue in 1H2016

***Calculated based on the old rates (4.0%, 3.0%, 2.0% for 1, 3 & 6 month loans respectively)**

Using an average interest rate of 7.5% and 3.0%* on M-shwari and KCB MPESA account respectively, we estimate that total revenue from loans from the two services contributed KES 646.2 million or 3.3% of the total MPESA revenue for the 1H2016.

In the short to medium term, we see this platform as more of a retention tool (value add) than a revenue generating platform. However, the revenue generating capacity can be enhanced as more lending opportunities such as in healthcare (emergency medical loans) are exploited and more partnerships with banks are established.

M-PESA as a Goods and Service Payments Platform

LIPA na MPESA was launched as a retail payments systems initially targeting SMEs. The platform is the primary driver for Person/Business to Business (P/B-to-B) (e.g. utility bill payments, cashless distribution) and Business to Person (B-to-P) transactions (e.g. dividend payments, salaries).

For the 1H2016, LIPA na MPESA had:

- 36,400 merchants active on a 30 day basis.
- Transacted KES 15.0 billion (September 2015).

P-to-B and B-to-B transactions can widen margins on MPESA.

***Bulk disbursements like salaries and dividends. Excludes Mshwari loans, Bank to MPESA, IMT which the company classifies as B-to-P.**

****Our transaction contribution margin only takes into account whether agent commissions are paid out.**

The company earns, on average, a transaction fee of about 0.8% and 0.3%* of the value of the transaction from P-to-B and B-to-P* respectively with a transaction contribution margin** of 100.0 % on each transaction. These types of transactions can be used to widen margins on MPESA.

We expect the company to aggressively roll-out the Business to Business platform. The company has already signed a number of fast moving consumer goods companies like Coca Cola, British American Tobacco, and East African Breweries where distributors accept MPESA payments from retailers. To make B-to-B transactions easier, the company has also enabled Paybill to Paybill transactions i.e. a business can use funds from its paybill account to make payments to another paybill account. The company earns on average about 0.5% of the value of transaction from cashless distribution.

Opening up of MPESA API will lead to new innovative payment solutions

***An API is a set of "rules" which software programs use to communicate with each other. In this case the MPESA API will allow an app to communicate with the MPESA server.**

Furthermore, the opening up of the M-PESA Application Programming Interphase (API)* to a wider pool of software developers is likely to herald a new era of innovative payments solutions. We expect this to increase the transaction velocity on MPESA which will further entrench MPESA as a preferred means of payments.

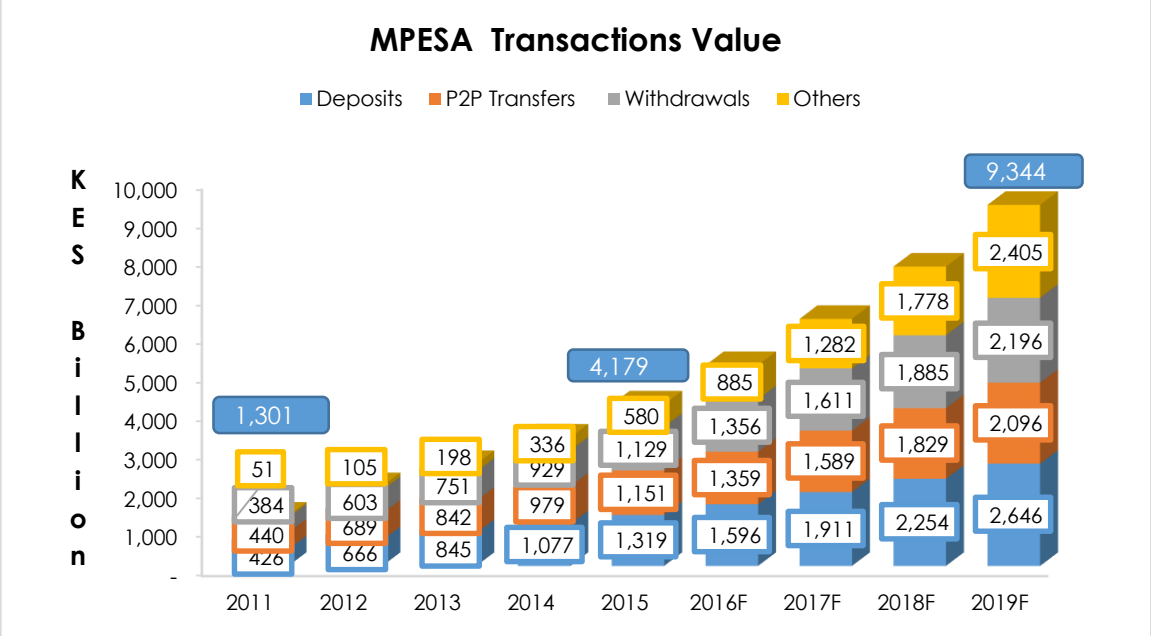
Where is the Growth?

Going forward M-PESA revenue will primarily be driven by growth in active users and increase in number of chargeable transactions.

We expect M-PESA active users to grow at a rate of 22.3% from 13.9 million (67.1% of Safaricom subscription) to 17.0 million (72.8% of expected Safaricom subscriptions) for the FY2016. Through the various initiatives we expect the average number of chargeable transactions to increase from 6.20(6 transactions) to 7.01(7 transactions) over the same period.

As a conservative measure and based on historical trends, we assumed a declining trend for the average size of the monthly transaction value per active user from KES 4,317(FY2015) to 4,194(FY2016). We therefore expect total transaction value for FY2016 to grow by 24.3% to KES 5,196 billion.

Assuming a similar trend (based on historical trends) for the effective yield on these transactions, we expect M-PESA revenue to grow at a rate of 21.4% to KES 39.6 billion.



Source: FIB Estimates, Company Filings

Consumer Behavior Change to Underpin Margins on M-PESA: Currently, M-PESA's EBITDA margin of 21.5% is the lowest of all major revenue lines (excluding equipment and acquisition revenues). This has a dilutive effect on the overall profit margin of the company.

We opine that margin improvement on MPESA will mainly be as a result of changing consumer behavior on M-PESA use. This ideally involves cutting out the "middleman" (MPESA agents) by encouraging more non-agent transactions to be done within the M-PESA platform i.e. reduce the amount of cash that goes in (deposits) and out (withdrawals) through the agents.

Deposits do not attract any transaction fee but commissions are paid out, on average, at a rate of 0.5% of the transaction value. Withdrawals attract a transaction fee of about 1.5% of the transaction value of which 37.0% is paid out as agent commissions.

For the FY2015, MPESA commissions represented 37.7% of the MPESA revenue, down from 40.2% in the FY2014.

The entrenching of the MPESA platform on most financial aspects of people's lives through initiatives like Lipa na MPESA, bulk disbursements, "Bank to M-PESA", IMT service and even the P-to-P service(can be used as an informal Lipa na MPESA service) will help cut out the agents.

Various MPESA initiatives will help cut out the middleman

For instance a user can receive salary through MPESA (bulk disbursement) instead of cash and use that money to pay for goods and services (Lipa na MPESA) instead of withdrawing to pay for the same in cash. A retailer can then use that money in the MPESA paybill account to settle payments with distributors, who are now accepting MPESA payments (cashless distribution).

Our Mpesa contribution margin represents the proportion of Mpesa revenue less MPesa commissions to total Mpesa Revenue.

To capture this, we forecasted a declining trend (based on historical trends) for the proportion of withdrawals and deposits. We expect the share of withdrawals and deposits to decline from 27.0% and 31.6% in FY2015 to 23.5% and 28.3% by FY2019 respectively.

Note: We have not taken into account the reduction in MPESA fees paid to Vodafone. The company is currently using a rate of 5.0% of MPESA revenues backdated from August 1st 2015. Negotiations are still on-going.

Consequently and assuming a declining on the effective yield on these transaction(based on historical trends), the proportion of M-PESA commissions to M-PESA revenue will decline from 37.7% (FY2015) to 28.9% by FY2019, lifting the MPESA contribution margin* from 62.3% to 71.1% over the same period. This will buoy the M-PESA EBITDA margin.

Competition Heats Up…

Competition in the mobile money segment is set to increase with the entry of 3 MVNOs: Finserve (Equitel) which is owned by Equity bank, Zion Cell and Mobile Pay (Tangaza). The Kenya Bankers' Association is also set to roll-out a real time mobile based bank to bank platform.

*Both SIMs cannot be used at the same time

Equitel seems the most formidable leveraging on a huge customer base and the "thin SIM" technology. The thin SIM allows customers to retain current providers and easily switch* (using a dialer code or through the SIM toolkit) between them.

Equitel's other notable advantages include a more interoperable platform and lower tariffs for P-to-P transactions. As the table below shows, Equitel users do not incur charges for P-to-P transactions done within the Equitel platform. It's also cheaper to transfer to MPESA accounts for amounts greater than KES 5,000 compared to transactions of similar amounts done on MPESA.

A Comparison of Person to Person Transfer Charges For MPESA and Equitel

Bands(KES)	Equitel to Equitel	Equitel to Safaricom	Safaricom to Safaricom
50-5,000	No charge	33.50-60.50	3.00-60.00
5,001-35,000	No charge	60.50	75.00-110.00

Source: FIB Calculations, Safaricom M-Ledger App
All charges Include a 10.0% excise tax

…Will Equitel Takedown MPESA?

In the short term, we see room for both platforms to thrive. We opine that Safaricom may even benefit (cutting out the agent) from Equitel as the latter will initially be used as a "Bank to MPESA" product.

MPESA has a much bigger eco-system

MPESA has a much bigger ecosystem (in terms of agents, subscriptions and payment products) and most Equitel subscribers (who may still be MPESA subscribers) will still use MPESA products (either in money transfers or paying for goods and services). The network effects will deter users from fully migrating to Equitel and any other new platform. We therefore do not see the cheaper pricing on P-to-P as a major threat for MPESA.

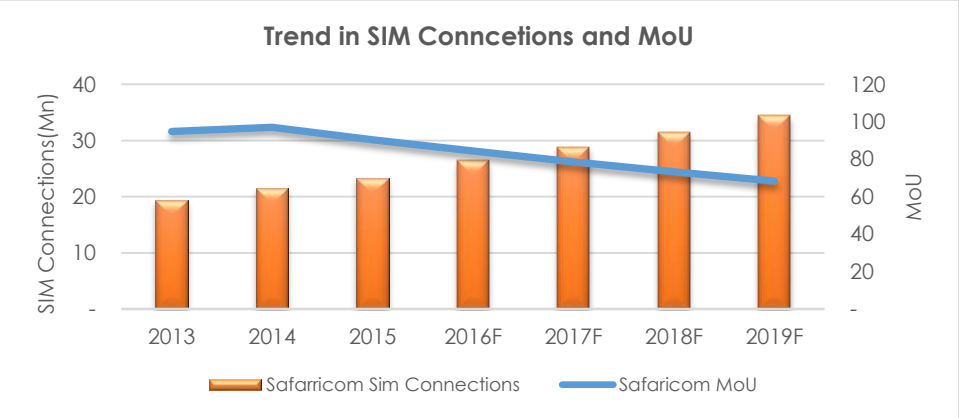
Moreover, about 94.0% of transactions are still cash based. There is still more headroom for all platforms to thrive. However as Equitel subscriptions grow (thereby increasing the network effects) and the platform is integrated deeper in the economy, there is a risk that a substantial chunk of the MPESA transactions could be taken away.

FINANCIAL PERFORMANCE

Slower Revenue Growth Going Forward: In line with global trends, we expect revenue growth for the company to grow at a slower CAGR (FY2015-FY2019) of 12.8% to KES 264.9 billion compared to a CAGR (FY2011-FY2015) of 14.6% (to KES 163.4 billion).

We attribute this to the gradual maturity of the voice and messaging segments and increased commoditization on the two services. For the FY2016, we expect revenue to grow by 12.7% to KES 184.0 billion.

Voice: Voice recorded a growth of 3.7% to KES 88.7 billion for the FY2015. We see limited scope in voice revenue growth due to reasons discussed earlier. Although we expect Safaricom to continue growing subscriptions as penetration levels increase, as the figure below shows, MoU is expected to decline. We estimate that MoU (national outgoing calls) on the network, without factoring promotional activities, will decline from 90.5 minutes in FY2015 to 84.3 minutes in FY2016. We therefore expect revenue to grow at a lower rate of 3.3% to 90.3 billion for FY2016.



Source: CA, FIB estimates

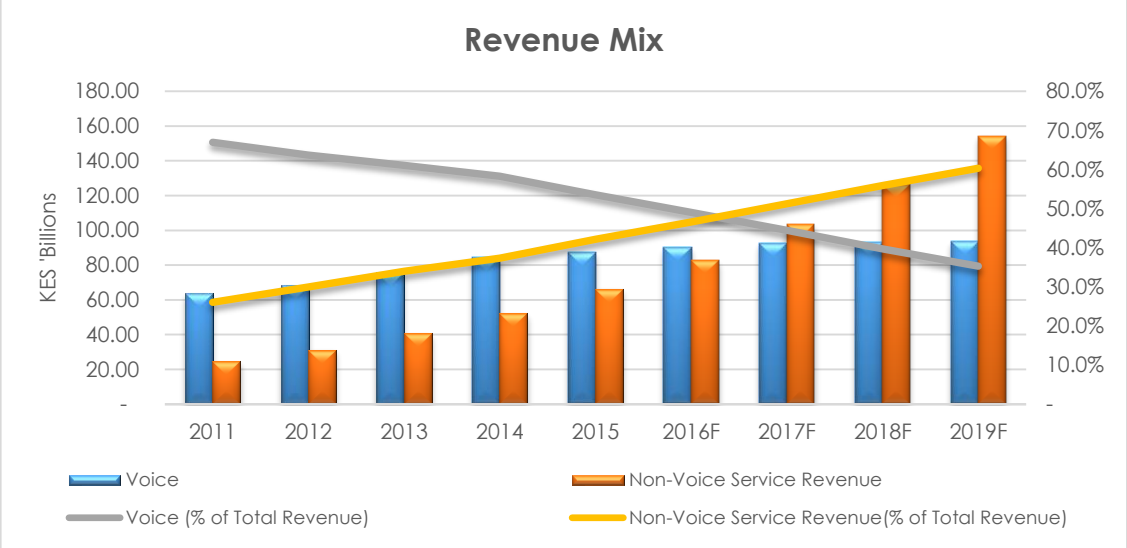
Messaging: The low smartphone penetration has shielded SMS revenues. The company has been able to grow messaging revenue through smart bundling, growth in SMS customers, USSD based products (e.g. mobile banking), promotional activities and SMS based content subscription services. The latter accounts for 35.0% of SMS revenues but is margin dilutive since the company shares in the revenues with content providers.

USSD- Unstructured Supplementary Service Data

The use of SMS as a P-to-P communication tool is likely to taper in the medium to long term as the uptake of OTT based messaging platforms like Whatsapp increases. In addition, USSD prices which are under a cost study by the CAK face the risk of downward revisions.

Going forward, we are likely to see SMS revenue being primarily driven by promotional offers and the use of SMS as Business/Government to Person (mostly through ads, subscription services and alerts) communication tool. For the FY2016, we project a lower growth rate of 12.9% in messaging revenues to KES 17.7 billion.

Non-Voice Service Revenues to Drive Top-line Growth: As the figure below shows we expect non-voice service revenues (excluding handset & acquisition revenue) to contribute over 50.0% of the revenue from FY2017. The key risk we see in this is that MPESA, which is a lower margin business line is fast replacing voice, a high margin business segment (EBITDA margin of 51.0%).



Source: Safaricom, FIB Estimates

Consumer Behavior Change on MPESA Use to Boost Company Contribution Margin: As earlier shown, reducing non-agent transactions will lift MPESA margins. This will offset to some degree the dilutive effect of MPESA on overall company margins. We also see the shift to more MPESA airtlme purchases as having a similar effect on overall company margins. For the FY2015, about 37.8% of the top-ups were done through M-PESA. M-PESA top ups saves the company on costs related to top-up cards such as card production, distribution and inventory management. Airtime commissions account for about 19.0% of the total direct costs.

***The figure was derived based on FY2012 financials**

According to *Fighting Poverty, Profitably* by the Bill and Melinda Gates foundation, making top-ups via MPESA would save the company, on average, USD 0.5* annually for every M-PESA user. Taking only the average active M-PESA users, this would translate to cost saving of KES 793.2 million (USD 7.8 million) for FY2016. In addition, MPESA's stickiness effect leads to low churn rates which ensure the company recoups investments made in networks and subsidies offered in customer acquisition.

MPESA and airtime commissions account for 40.0% of the direct costs. A significant change in the proportion of the two line items will have an impact on the intensity of direct costs. Partly as result consumer behavior change on M-PESA use, we expect direct costs intensity to decline from 34.7% (FY2015) to 27.4% by FY2019. This will lift the company's contribution margin from 65.3% to 72.6% over the same period. We have not taken into account reduction in MPESA fees paid to Vodafone.

Continued Cost Containment Should Keep OPEX Tamed: The Company's continued focus on containing transmission, IT and network operating costs has seen OPEX intensity decline for the better part of our review.

We partly attribute this to the vast economies of scale which enable the company, for instance, to negotiate favourable contract terms especially in network management (managed services). The company has already renegotiated rates on maintenance of the active network with various equipment vendors (Huawei, Cisco, Ericsson, Nokia Solutions Networks) and is in the process of doing the same for passive network (security, tower maintenance, fueling).

We also note that investments made in network improvements have also rationalized costs. Some of these initiatives include:

- Replacement of wholesale (leased) fibre backhaul network with own fibre. This has lowered the dependency on leased capacity.
- The deployment of a single RAN solution* should keep energy costs and volume of equipment under maintenance in cell sites low.

***A Single RAN solution allows operators to support multiple technologies (2G, 3G, and 4G LTE) on a single network i.e. without the need for separate equipment. A key feature is a software defined radio in the base station.**

We expect the company to use some of its new business lines to further cut costs. The company may use its own broadcasting services to cut advertising spend. However, this depends on the company's ability to woo customers with appealing content. In the long term network consolidation (transitioning to an all-IP network for all services) will simplify network management hence realizing further OPEX savings.

For the FY2016, we expect OPEX intensity to be maintained at 22.1% despite the volatility of the exchange rate in the 1H2016. This coupled with the lift in contribution margin will lift the EBITDA margin (includes other income) from 43.6% in FY2015 to 45.1% in FY2016.

Significant Lift in Return Ratios: Our ratio analysis reveals that over the past 4 years the company has consistently grown return on average equity and average assets. We attribute this to growth in the top-line coupled with cost containment measures which has improved operating margins, de-levering of the balance sheet and improved cash position (which earn interest income for the company) which have lowered the interest burden. We expect this trend to be maintained over our forecast period.

The table below shows a deeper analysis and comparison, using the Dupont analysis, of the above return metrics for the FY2015 and FY2016.

Dupont Analysis	FY2015	FY2016
Tax Burden: NI/EBT	69.1%	69.1%
Interest Burden: EBT/EBIT	100.9%	100.5%
EBIT(Operating) Margin: EBIT/Sales	28.0%	29.9%
Total Asset Turnover: Sales/ Average Assets	112.1%	115.7%
Return on Average Asset (ROaA)	**21.9%**	**24.1%**
Financial Leverage: Average Assets/Average Equity	149.1%	143.8%
Return on Average Equity (ROaE)	**32.6%**	**34.6%**

Source: FIB, Company Reports

The analysis reveals that for the FY2016, the lift in return ratios will be mainly by an increase in operating margin (from 28.0% to 29.9%) and asset turnover (from 112.1% to 115.7%) which indicates a better utilization of assets. We expect KES 3.3 billion in debt to hit the balance in the 2H2016 as company retires the bond and pays dividends.

The decrease in financial leverage (from 149.1% to 143.8%) affects the ROaE negatively but we don't see this as a cause for concern as it only indicates that the company is financing most its assets through equity-retained earnings rather than debt and also gives it some leeway to take up more debt should it need it, in future.

Income Statement

For the year ending 31st March KES "000	2013A	2014A	2015A	2016F	2017F	2018F	2019F
Voice Revenue	75,850,000	84,368,191	87,406,168	90,252,100	92,835,763	93,277,902	93,582,492
y-o-y %	11.3%	11.2%	3.6%	3.3%	2.9%	0.5%	0.3%
Voice ARPU(KES)	*328.35*	*342.96*	*324.09*	*302.16*	*281.72*	*262.66*	*244.89*
EBITDA Margin %			*51.0%*				
Messaging Revenue	10,147,295	13,619,377	15,632,926	17,648,764	19,699,047	21,229,179	22,844,074
y-o-y %	30.6%	34.2%	14.8%	12.9%	11.6%	7.8%	7.6%
Messaging ARPU(KES)	*43.9*	*55.4*	*58.0*	*59.1*	*59.8*	*59.8*	*59.8*
EBITDA Margin %			*42.0%*				
Mobile Data Revenue	6,610,580	9,313,532	14,823,188	21,559,117	31,385,795	43,623,389	58,440,660
y-o-y %	26.6%	40.9%	59.2%	45.4%	45.6%	39.0%	34.0%
Mobile Data ARPU(KES)	*92.3*	*91.6*	*113.8*	*129.6*	*155.6*	*186.9*	*224.4*
EBITDA Margins %			*51.0%*				
Fixed Data Revenue	2,112,552	2,570,901	3,128,042	3,806,716	4,632,639	5,637,758	6,860,952
y-o-y %	54.2%	21.7%	21.7%	21.7%	21.7%	21.7%	21.7%
EBITDA Margin %			*46.0%*				
MPESA Revenue	21,844,032	26,561,297	32,625,688	39,595,421	47,556,030	56,250,485	66,225,786
y-o-y %	29.5%	21.6%	22.8%	21.4%	20.1%	18.3%	17.7%
MPESA ARPU(KES)	*185.6*	*195.0*	*209.0*	*221.3*	*232.0*	*239.6*	*246.4*
EBITDA Margin %			*21.5%*				
Total Service Revenue	**118,054,459**	**138,360,663**	**156,246,631**	**176,018,862**	**199,897,365**	**224,564,423**	**253,408,815**
Total Revenue	**124,290,958**	**144,672,477**	**163,364,121**	**184,044,869**	**208,947,857**	**234,770,172**	**264,917,284**
y-o-y %	**16.2%**	**16.4%**	**12.9%**	**12.7%**	**13.5%**	**12.4%**	**12.8%**
Direct Costs	(47,173,851)	(51,963,714)	(56,708,576)	(60,958,552)	(65,348,929)	(68,991,967)	(72,662,031)
Contribution Margin	**77,117,107**	**92,708,763**	**106,655,545**	**123,086,317**	**143,598,928**	**165,778,205**	**192,255,253**
Operating Costs(OPEX)	(27,880,000)	(31,770,000)	(36,039,990)	(40,602,399)	(46,096,283)	(51,792,980)	(58,443,777)
EBITDA	**49,242,341**	**60,943,298**	**71,298,876**	**82,915,019**	**97,992,078**	**114,535,143**	**134,432,010**
Net Income	**17,542,912**	**23,017,537**	**31,871,303**	**38,268,538**	**46,851,282**	**56,842,049**	**69,295,569**
Growth %	*38.9%*	*31.2%*	*38.5%*	*20.1%*	*22.4%*	*21.3%*	*21.9%*
Earnings Per Share, EPS(KES)	0.44	0.57	0.80	0.96	1.17	1.42	1.73
Dividend Per Share, DPS(KES)	0.31	0.47	0.64	0.77	0.94	1.14	1.39

Note: We account for revenues and costs relating to the police security network as Other Income and OPEX respectively
EBITDA Margins for the revenue lines provided by management.

Balance Sheet

As at March 31st KES "000	2013A	2014A	2015A	2016F	2017F	2018F	2019F
Assets							
Non-Current Assets	103,500,133	106,279,478	124,367,073	129,925,317	136,027,841	134,945,382	130,011,266
Current Assets	25,356,024	28,321,468	32,590,553	31,191,943	38,387,836	52,230,096	69,997,406
Total Assets	128,856,157	134,600,946	156,957,626	161,117,260	174,415,676	187,175,477	200,008,672
Liabilities							
Non-Current Liabilities	12,000,000	5,102,380	490,762	-	-	-	-
Current Liabilities	36,591,029	38,262,587	52,190,333	44,214,065	41,449,932	35,061,615	24,331,184
Total Liabilities	48,591,029	43,364,967	52,681,095	44,214,065	41,449,932	35,061,615	24,331,184
Total Equity	80,265,128	91,235,979	104,276,531	116,903,195	132,965,744	152,113,863	175,677,487
Total Equity and Liabilities	128,856,157	134,600,946	156,957,626	161,117,260	174,415,676	187,175,477	200,008,672

Ratio Analysis

	2013A	2014A	2015A	2016F	2017F	2018F	2019F
Return Ratios							
Return on Average Equity	23.0%	26.8%	32.6%	34.6%	37.5%	39.9%	42.3%
Return on Average Assets	14.0%	17.5%	21.9%	24.1%	27.9%	31.4%	35.6%
Return on capital Employed	17.5%	22.2%	27.7%	31.8%	34.3%	36.4%	38.5%
Profitability Ratios							
EBITDA Margin	39.6%	42.1%	43.6%	45.1%	46.9%	48.8%	50.7%
Net Profit Margin	14.1%	15.9%	19.5%	20.8%	22.4%	24.2%	26.2%
Contribution Margin	62.0%	64.1%	65.3%	66.9%	68.7%	70.6%	72.6%
Liquidity Ratios							
Current Ratio	0.69	0.74	0.62	0.71	0.92	1.47	2.82
Quick Ratio	0.63	0.66	0.47	0.63	0.84	1.37	2.67
Cash Ratio	0.41	0.46	0.27	0.27	0.57	1.02	2.14
Coverage Ratios							
EBITDA/Finance Costs	17.3	32.4	52.9	95.2	173.9	155.4	134.9
EBIT/Finance Costs	9.5	18.7	33.9	63.3	118.7	109.3	98.0
Leverage Ratios							
Debt/Equity	0.25	0.14	0.10	0.03	0.03	0.03	0.02
Debt/Capital employed	0.16	0.09	0.07	0.02	0.02	0.02	0.02
Debt/EBITDA	0.41	0.21	0.15	0.04	0.04	0.03	0.03
Debt/Total Assets	0.16	0.09	0.07	0.02	0.02	0.02	0.02
Total Assets/Total Equity	1.61	1.48	1.51	1.38	1.31	1.24	1.14

VALUATION

We used an equal weighting of the EV/EBITDA multiple valuation and Dividend Discount model, as shown below.

EV/EBITDA Multiple Valuation	
Current Market Price(03/16/2016)	16.40
Market Cap	657,073,019
Market Value of Total Debt	10,639,980
Minority Interest	-
Less:	
Cash and Cash Equivalents	(14,030,309)
Enterprise Value(EV)	**653,682,690**
EBITDA(2015)	71,298,876
Trailing EV/EBITDA	9.17
Forecasted EBITDA(FY2016)	82,915,019
Forecasted EV(2016)	760,181,866
Less:	
Market Value of Debt(FY2016)	(3,299,089)
Minority Interest	-
Add back cash & cash equivalents	11,923,286
Forecasted Market Cap	**768,806,062**
Target Price	**19.19**
Upside/(Downside) Potential	17.0%

Dividend Discount Model

Risk free rate(10 Year Bond Yield)	**13.67%**
Beta(Based on the All Share Index)	**1.28**
Cost of Equity	**15.38%**
Terminal Growth Rate	**10.00%**

Year	**2016**	**2017**	**2018**	**2019**	**Terminal Value**
Period	**1.00**	**2.00**	**3.00**	**4.00**	
Dividend Per Share(KES)	0.768	0.941	1.141	1.392	28.672
Discount Factor	1.154	1.331	1.536	1.772	1.772
Present Value	0.666	0.707	0.744	0.786	16.067
Sum of All Present Values(Target Price)					**18.97**
Upside/(Downside) Potential					15.3%

	Target Price	**Weight**	**Value**
EV/EBITDA Multiple Valuation	19.19	0.5	9.59
Dividend Discount Model	18.97	0.5	9.48
Weighted Target Price			**19.08**
Upside Potential			16.33%

COMPARABLE ANALYSIS

Company	Price(USD) 03/16/2016	EBITDA(USD)	EV/EBITDA	EBITDA Margin %	P/E	P/B	ROE %	ROA %	ROIC %	Dividend Yield %	EPS(USD)
Africa											
MTN Group	8.94	4153.7	5.48	35.8	17.81	1.65	14.70	7.12	9.33	9.86	1.01
Telecom Egypt	0.88	397.6	3.64	21.13	3.66	0.38	10.76	8.96	6.23	0	0.23
Orascom Telecom	0.08	234.5	3.64	75.19	213.32	1.06	-0.93	-0.62	12.99	0	N/A
Econet	0.232	279.2	3.63	37.4	12.88	1.28	11.15	5.78	8.91	1.79	0.04
Safaricom	**0.16**	**797.3**	**9.56**	**43.53**	**21.31**	**6.55**	**32.6**	**21.86**	**30.95**	**3.75**	**0.01**
U.S											
T-Mobile(U.S)	37.18	6,966	7.51	21.1	39.58	1.93	4.21	1.23	3.65	0	-0.16
Sprint	3.57	6,000	12.66	10.0	N/A	0.65	N/A	N/A	N/A	0	-0.43
AT&T	38.77	47,095.0	7.12	32.1	14.10	1.72	12.58	3.82	5.58	5.49	2.44
Verizon	53.21	46,567.0	6.01	35.4	11.58	11.46	124.48	7.49	12.26	4.82	3.99
Middle East											
Saudi Telecom	18.47	5,035.2	6.60	37.2	14.78	2.26	15.31	9.87	17.16	5.85	1.24
Etihad EtisalaT	7.36	784.1	11.67	20.4	11.09*	1.40	-6.25	-2.43	-2.82	0.00	-0.38

Source: Bloomberg, FIB; *FY2013

Safaricom currently trades at higher trailing P/B, P/E and EV/EBITDA multiples compared to most of its African peers. This is justifiable given its hugely successful mobile money service. In addition, the company's return on invested capital and return on assets shows a better utilization of capital and assets compared to other companies.

CONCLUSION

We initiate coverage on Safaricom with a **BUY** recommendation on the stock with a target price of KES 19.08 providing an upside/downside potential of 16.33% from the current (03/16/2016) share price level of KES 16.40.