

# Conference Call transcript

4 November 2016

## SAFARICOM RESULTS

### Operator

Good afternoon ladies and gentlemen and welcome to Safaricom's first half 2017 results conference call hosted by SBG Securities. All participants will be in listen-only mode. There will be an opportunity to ask questions at the end of today's presentation. If you should need assistance during the conference please signal an operator by pressing star and then zero. Please also note that this conference is being recorded. I would like to hand the conference over to Mr Gregory of SBG Securities. Please go ahead, sir.

### Gregory Waweru

Thank you. Good morning, good afternoon ladies and gentlemen. SBG Securities and Standard Bank today have the pleasure of hosting the Safaricom half-year results conference call. Hopefully you have all received the presentation and results circulated earlier today. The team will now summarise the presentation and we will then open the call for Q&A. So without further ado I would like to introduce the Safaricom team, Bob Collymore, Sateesh Kamath and Vincent Opiyo. Bob and Sateesh, over to you now. You may go ahead.

### Bob Collymore

Hi folks. Actually we have Sateesh with me, CFO, and we also have the Director of Corporate Affairs who is Stephen Chege with me on the line. So we are pleased to be announcing the first half of the year 2016/17. We think with our results our customer base grew by 1.5 million customers, and that was a 6% at 26.6 million customers. Our service revenue almost hitting Kshs 100 billion, a 15.4% growth. We are pleased that voice continues to show reasonable growth at 1.1%. This is despite many people predicting that it would level out and start to decline. We never thought that would be the case because we knew that we would continue to grow customer numbers, and in growing customer numbers whilst you would see a reducing ARPU you would still overall see a rise in voice revenues.

Drivers for the growth were messaging to a degree, but I say to a degree because still 8% growth is still quite respectable in these days and ages where many operating companies are seeing a decline in messaging. But the big stars for us were of course M-PESA and data. Data has remained relatively consistent at 46.3%. I think that growth was a little bit higher than it was the same time last year at 3.7% I think aided and abetted a little bit by the growth in the gaming and betting industry here in Kenya. The underlying growth is still in line with what we would expect it to be did we not have gaming and betting.

The EBITDA has come in at Kshs 50.8 billion, therefore 30.8% growth and representing a 49.8% EBITDA margin. However we would point out there was a one-off adjustment of Kshs 3.4 billion. So the underlying EBITDA margin is at 46.5%. We will talk a little bit about the guidance in a little while. Net income similarly grew by 6.4% to almost Kshs 24 billion. And that excludes the one-off balance sheet adjustment of the Kshs 3.4 billion that we talked about a moment ago. So the real net income growth is about 13.8% and free cash flow is up to Kshs 20 billion.

The guidance has been increased for the full year. so whereas we had originally predicted Kshs 89 to Kshs 92 billion for EBITDA we are increasing that to Kshs 94 to Kshs 97 billion. That is roughly a Kshs 5 billion uplift on the

original guidance. And the second thing that we guided on is capex. We are expecting to be spending an additional Kshs 2 billion in capex over the full year.

The network is just over 4,000 base stations and we have had a good growth in 4G. We expect to finish this financial year with about 1,100 4G base stations. We have accelerated and front-ended a lot of our investment so that we can get the benefits for a larger part of the year. We are seeing a pretty good uplift in data ARPU as we move customers from 3G to 4G. Smartphone handsets are currently sitting at just under 10 million smartphones at the moment. So I think that summarises what we will see in the numbers, and you probably had a bit of a chance digest them before we came on the call. So we will open it up to questions, questions on finance, questions on anything. I'm sure the CFO and I should be able to give you some answers.

### **Operator**

Thank you very much sir. Ladies and gentlemen, at this time if you would like to ask a question you're welcome to press star then one. That will place you in the question queue. If you however decide to withdraw the question you're welcome to press star then two to remove yourself from the question queue. We have a question from Bahar Makaram [?] from Arqaam Capital.

### **Bahar Makaram**

Hi. Thanks very much for the presentation. Could you give us a bit more colour on what the Kshs 3.4 billion one-off was? Could you shed some light on that please?

### **Sateesh Kamath**

Sure. The Kshs 3.4 billion is a one-off adjustment which we have done in the first half year. This is basically a write-back of a provision which was made over a few years on an ongoing dispute which was finally settled at a far lower value than what we provided for in the books. This write-back of Kshs 3.34 billion you would see Kshs 2.2 billion of this reflected in the other income line and Kshs 1.1 billion in the opex line.

### **Bahar Makaram**

Got it. Thank you very much.

### **Operator**

Thank you. The next question comes from Chris Grundberg of UBS.

### **Chris Grundberg**

Thanks. Just a couple. You mentioned the trends that you were seeing. I just wondered if you could comment first on the fixed service revenues, how you see things going there, what your prospects are for the remainder of the year and maybe into FY18. And then secondly on mobile data I wonder if you can comment on what you have seen since period end. Any specific comment on whether that trajectory is going to be able to be sustained. Thanks.

### **Sateesh Kamath**

Thank you. On the fixed data revenue we have laid the foundations for setting up this business. We are connecting more businesses to fibre. As of end of this period we have more or less doubled the number of buildings in the country that have been connected by fibre. We are in the state of laying a foundation and we believe we have much more growth left there. When I speak of the mobile data business, the data business as Bob alluded earlier has been very strong for the year. Roughly half of the data growth for the year has come from additional customers who have now become data customers. The other half of the growth is coming from increase in ARPU. We see strong increase in data usage per customer now to 250 MB which is far smaller than what we see in Europe. So there is far more to go. In the course of the first half we also reduced effectively by

segmented offers the price that we offer for data to the customers. So we saw a 16% decline in the rate. However the volumes went up by more than 70%, so overall delivering a strong 43% growth.

**Chris Grundberg**

Thanks. That's very helpful. Thank you.

**Operator**

The next question comes from Binta Drave of Exotix.

**Binta Drave**

Thank you very much. Thanks again for the presentation. The main question is regarding your M-PESA business. I just wanted to have a bit more colour on the evolution of what you call the new businesses, especially if you can shed some light on Lipa Na M-PESA. And also the second question will be regarding news flow that we've seen on local newspapers stating that transactions below Kshs 100 will not be charged.

**Sateesh Kamath**

Sure. Let me take the first part of the question and then come to the transactions below Kshs 100. Actually slowly we will get adjusted to this new terminology that we use of new business and bread and butter business. Let me explain what we mean by this. If you go back four or five years in M-PESA's history more than 95% of the revenues in M-PESA came from the withdrawals and B2B revenues. These two revenue streams are what we call bread and butter businesses. Over the last five years we have had a number of businesses on top of those which is what we call new businesses.

When we look at M-PESA's growth for the year roughly half of it comes from new businesses and half of it comes from bread and butter more or less. So we continue to do more transactions and get more customers to use M-PESA in the classic products of P2P and withdrawals. At the same time we have got relevant products for the relevant segments which could be P2P, it could be Lipa Na M-PESA, it could be M-Shwari or IMP as the case may be, which is together what we call the new business delivering 3.8%. Specifically on your query on Lipa Na M-PESA, Lipa Na M-PESA is growing at a rate of over 70% or so year over year.

Your other question was the BOP. Because the product M-PESA Kadogo. The idea for that is actually part of the larger thought that Safaricom has of being a company with a purpose and having an impact on the society. We had done various surveys and also read some research which showed a significant portion of the transactions in the country still continue to be in cash. We think that is a segment of the company which should be included in banking or financial inclusivity. So at the start what we have voluntarily done at this time is to say all transactions below Kshs 100, the majority of which we think is happening in cash currently, we will do free P2P with M-PESA for that particular segment. And that's the start point. And pre-empting your next question on what the impact could be, the impact that we see at this point in time of the volumes below the Kshs 100 mark is roughly Kshs 500 million. However we believe this will expand the ecosystem and in the matter of a few quarters we will probably get back to where we were because of the rub-on impact this will have in the larger ecosystem.

**Binta Drave**

Many thanks. Thank you.

**Operator**

The next question comes from Gabor Sitanyi of Charlemagne Capital.

**Gabor Sitanyi**

Hi. Good afternoon. Thanks very much for the opportunity. Just two things perhaps. On the transactions on M-PESA, this phenomenal growth to 9.3 times per month, can you perhaps isolate what part of that increase was due to the gaming and betting as you mentioned at the beginning, the sports betting, and is that an ongoing feature which we should include in our numbers going forward? Secondly I wanted to ask about the EBITDA margin which you mentioned is already on a clean basis at 46.5%. How do you see that developing? Do you feel that has plateaued or do you see further benefits potentially from the economies of scale? Thank you.

**Sateesh Kamath**

Let me answer the second question first. Of the 46.5% EBITDA margin we think we are at a healthy EBITDA margin. We continue to get economies of scale and we constantly keep reviewing it and seeing how we can pass it back to the customer so that we have a sustainable business in the long run, which is why you have seen that this year we have reduced our data prices by 16% despite having a strong leadership and not a strong volume of competitive pressure to necessarily do it. So we are very customer-centric and not only profit margin driven. However having said that we have a close eye on our costs. And if the revenues continue to grow faster we may have a slight movement in margin. But we are very happy with the current level of margins that we have.

**Bob Collymore**

As are you, actually Gabor. As long as I've known you, you have asked me for more EBITDA margins. 46.5% is actually a pretty good rate and any increase would be a little bit speculative at this stage.

**Sateesh Kamath**

My apologies. Do you mind repeating the other question that you had?

**Gabor Sitanyi**

Not at all. Concerning the 9.3 times per month transactions perhaps if you could isolate what part was that new element, the sports betting and gaming, and should we count on this as an ongoing feature in our numbers?

**Sateesh Kamath**

Sure. I'm happy to explain that. You would recollect that we had something like 6.5 transactions per active customer two years ago, which went to 7 last year. And now we see 9.3 transactions per active customer. The last increase of 7.6 to 9.3 or so actually is driven by both underlying business growth as well as the sports. Roughly 60% of the volume was because of sports betting in terms of number of transactions because it drives more smaller transactions, and the balance of the business was the underlying. It could be 62/38 or something like that.

**Gabor Sitanyi**

Thank you very much.

**Bob Collymore**

We would advise you not to assume that it is going to be ongoing. In fact in our own internal reporting we report with and without. It could be volatile. It might be there for the long term but it could be volatile. So underlying we will strip out a certain percentage points out of this.

**Gabor Sitanyi**

To elaborate a little bit, you wouldn't consider this ongoing because it is related to a special promotion or it is a new app and as long as the customers are using this it could still feature.

**Bob Collymore**

We think it is such a big phenomenon here in Kenya that it could easily turn out to be a fad. We don't really want to build our business based on a fad. And social pressures could squeeze it. We are already seeing a heavy squeeze on taxation. But if it becomes socially less acceptable then this could business could disappear. I'm not saying it will.

**Gabor Sitanyi**

Thank you very much.

**Operator**

We have a follow-up question from Chris Grundberg of UBS.

**Chris Grundberg**

Sorry, just one clarification and then a couple of follow-ons. Just on your volumes that you reference as being at risk on the sub Kshs 100 transactions, the Kshs 0.5 billion, is that presumably the annual figure? And then second, presumably the rates you were charging on those low-value transactions were lower so in terms of revenue impact it would be fairly small as well. Is that a fair assumption?

**Sateesh Kamath**

Just to clarify, the Kshs 0.5 billion number that I explained is the impact on revenue, not on volumes. If you were trying to calculate the volumes multiplied by rate I'm just saying rather I give you the number. What we see is initially we will see a dip. Then the ecosystem will start getting much bigger and there is what we call a consolidation impact. What we mean by that is the small mom and pop shops will now start accessing more transactions. So their value will accumulate. And they have to go ahead and withdraw or transfer that value at some stage, which will have a volume increase in a slightly different line and we will start seeing numbers coming back to us in a matter of time. But initially it will be less than Kshs 0.5 billion on an annualised full-year basis.

Got it. That's a helpful clarification. Then in terms of the follow-on I wonder if you could comment on the competition in the market. I wonder if you see anything from Orange or any impact from Equitel recently. And then the final one just in terms of the competition authority and the process regarding market dominance. Where are you on that? Are we still thinking that's not anything imminent or any update at all? Thanks.

**Bob Collymore**

Okay. Let me take the question on the competition and then I will ask Steve to deal with the regulatory front. And maybe you can give us a broader overview of the regulatory dominance story. The competitors are actually relatively quiet. Airtel in particular have been relatively quiet. There are local promotions in parts of the country but nothing spectacular. Orange have launched some new bundles. Pretty aggressive, but I think they need to reaffirm themselves in the marketplace having gone through several months of uncertainty around ownership. None has had much of an impact on us. I haven't seen the CA numbers. I haven't done a comparison on the CA market share numbers since Helios came on board. None of it is that spectacular. We saw better pricing on things like data and voice bundles but the market is not... They have actually increased their market share from March to June from 12.5% to 13.2%. So a little bit of a move, but less than 1%. Equitel, they have got their data on Q3 yesterday I think. We have seen some growth with them. Quarter on quarter we have seen them grow their market share from 4.4% to 5.1% since June 2016. And frankly the banks have got their own challenges here in the marketplace and if I was a CEO who had a bank and an MVNO I would probably be focusing a lot more on my banking business than my MVNO. I will ask Steve to talk a bit about the regulatory landscape in general and more specifically the dominance.

### **Stephen Chege**

On the dominance story this is something that has been overhanging us for quite some time given the size and market share that Safaricom has. What is happening now, which we have disclosed, is this is ongoing by the regulator. All they want to do is assess the market segment and find out the levels of compensation in each of the market segments. We have been participating in this. The outcome we expect to come in Safaricom Q4. And we don't expect anything that we haven't planned for. We think it will be around wholesale interconnect pricing. Currently we have the lowest interconnection rate in Africa, so that's not an area that we are concerned about. There could be some discussion around infrastructure sharing. We have already gone ahead and had commercial agreements with all our competitors and we don't see the regulator looking too deeply into prescribing the prices there.

Retail price control is an area that no one in the country has ever wanted to put forward but it is one of the levers that they could consider. But we don't think it is one that will actually be followed through. We might be declared dominant, yes. What would be required for us in such an environment? More regulatory scrutiny, more reporting, more transparency in how we deal with smaller companies. But we don't think it is going to have a significant impact on how the business is managed. On other issues around spectrum we are currently acquiring the 4G license. You will actually be seeing the announcement today at a price of \$35 million. This is going to trickle down to our competitors in the first quarter next year. For Airtel we don't know what timelines.

The other issues that are usually important around this space is subscriber registration. This is a point for many governments especially where there are issues around security. We have complied with this and had discussions with the ministry as an industry, not just as Safaricom, to ensure the regulations around subscriber registration are made more easy to comply with. I think that's what I would say in terms of the regulatory environment. It has been very smooth. The only issue we would point out is the one on the competition study, but the outcome I think we have planned for.

### **Chris Grundberg**

Fantastic. Thank you.

### **Operator**

Thank you very much sir. The next question comes from Gregory Waweru of SBG Securities.

### **Gregory Waweru**

Thank you very much. Just two quick questions. Could you perhaps give us a sense around your views on M-PESA ARPU development? Clearly it appears your traditional P2P and withdrawals seem to have re-accelerated. Would I be correct in assuming that this still has a more dominant impact on ARPU? And secondly on opex intensity some good efficiencies there. Do you expect to hold to the current levels or do you see scope for further improvements particularly in the second half of the year?

### **Sateesh Kamath**

Let me give you the answers in the reverse order. I would just like to draw the fact that in the opex intensity we have a one-off of Kshs 1.1 billion out of the Kshs 3.34 billion that we mentioned. So when you are factoring it please do factor for that on an underlying basis. On an underlying basis really opex intensity has improved by 20 basis points. If you ask me when I look at telcos across the globe opex intensity of 21% is extremely healthy. Would I be too much worried about that? I would rather be investing in those places which may create a better opex but will bring a sustainable revenue stream for the future. It has worked very well for us. Look at the 3G and 4G rollout for example. We accelerated it and increased a bit of opex but are able to monetise what we are spending. That would be my guidance for opex intensity. I wouldn't model too much reduction of opex intensity in and around the current level, probably a little bit of reduction but not much.

**Bob Collymore**

The second question was on M-PESA ARPU.

**Sateesh Kamath**

Let me explain it as M-PESA revenue itself. It goes hand in hand with ARPU. You are absolutely right. Our revenue streams also worked very well this year. Person-to-person transfers, volumes increased, value increased and consequently [unclear] increased. The jaws also did the same thing. So we are seeing an ARPU uplift both from the traditional segments as well as from new business segments.

**Gregory Waweru**

All right. Thank you.

**Operator**

We have a follow-up question from Bahar Makaram of Arqaam Capital.

**Bahar Makaram**

I had a quick question about your M-PESA. Have there been any discussions about spinning it off as a separate entity? And if not then what are your thoughts on that as a possible move in the near to medium-term future? Thank you.

**Bob Collymore**

There are no immediate thoughts. You can never say never. But right now there are no plans for the management or the board to do that.

**Bahar Makaram**

Okay. And is there anything you can give us on what your thoughts might be on the move, or is that better left for later?

**Bob Collymore**

I think it is one of those better left for later.

**Bahar Makaram**

Okay, perfect. Thank you very much.

**Operator**

We have a follow-up question from Binta Drave of Exotix.

**Binta Drave**

Hi have a follow-up basically on the voice ARPU which declined by 8%. In your view what is the outlook going forward? Do you expect further weakness or a stabilisation from the current level?

**Sateesh Kamath**

Thank you Binta. The way we look at voice now is voice is an extremely strongly commoditised business. We are looking at innovative ways of ensuring that we hold on and probably even marginally grow our voice revenues. We have actually shifted the focus from ARPU to looking at what type of products we offer to what segment to sustain this revenue. The way we look at it is to look at the volume increase in voice, which is roughly 10% year over year. We added new subscribers through our strategy of going revenue where we have now been able to go into those portions of the society which we otherwise didn't, which means the ARPUs would come down. But

what we are now driving is overall revenue growth. So overall 10% increase in volumes overall, 3% on a per subscriber basis, 9% decline in rate per minute. That is the combination of how we have levered the businesses. And I would encourage us to start looking in voice revenue specifically more at the total revenue growth rather than what I get from that particular customer, which is ARPU.

**Binta Drave**

Thank you.

**Operator**

Ladies and gentlemen, just a final reminder, if you would like to ask a question you're welcome to press star then one. We have a question from Eric Musau of Standard Investment Bank. Thank you.

**Eric Musau**

Thank you. Just two or three questions. I think recently, Bob, you were quoted saying that M-PESA had to be more open and ubiquitous to survive. I would like you to elaborate a little bit more what you meant, and what you are thinking around M-PESA in the context of more competitive activity around financial services in that space. My second question is on the smartphone numbers. I think I have 4.1 million smartphones last year and I think this year you have mentioned 10 million. I'm just wondering whether that's the correct number. What has driven this significant jump of 30% or 40% increase in smartphone numbers? And then on fixed data I would like a little bit more colour on Kenya Power, the agreement you have on putting delivery of fibre to the home. How far are you? Are you on target? I think the idea was to deliver a certain number of homes by December. Are you on target and so forth? I think those are my questions. Thank you.

**Bob Collymore**

Let me take the first one. You know when we brought the second generation platform to Kenya and released the API we were very excited about it and everyone was very excited about it. But then we realised it is a pretty clumsy API. This is probably one of the worst interfaces we have ever seen. And so we are taking a different view. We have got a new Director of Financial Services in, Ron Webb. And Ron is coming from Equitel and before that he was involved in the development of Equitel. Ron himself looked at it and said we have to take a very different approach to how we do the API. So we are working on making it a lot easier and a lot more open for business. So we probably between us and our partner we probably thought we knew too much about APIs without really understanding from the developer's perspective.

On the fixed data question Sateesh will give you the smartphone growth. We did sign the MOU with KPLC. We have very different paces at which we work. Let's put it that way. Things are moving on. It is moving on very slowly. We have made a commitment to star to get into people's homes by the end of the year, so we are running our own pilot and running our own fibre to the home here in Nairobi. And we are expecting to have the first homes connected by the end of November actually.

**Sateesh Kamath**

Eric, on smartphone growth you are right. There has been a sharp increase in smartphone growth. Let me qualify this appropriately. How we measure the smartphones is by looking at the various models that appear when a call or a data [unclear] in our network. And we classify them based on our knowledge of the phone as a basic [?] phone, as a 3G phone, as a 4G phone, as a smartphone etc. We see a sharp increase in data using phones if I may put it that way. We are now reassessing the definitions to see should we be downgrading the definition of smartphone to 3G phones for some of the phones that we see. What we are definitely seeing is data-capable handsets have gone up to close to 9.5 million phones in our network. We are reassessing our definitions to see should we be calling X number a smartphone and the rest 3G phones. That is more a fine-tuning. What we see is most of these phones are using data and our data volumes are growing.

**Eric Musau**

Thank you very much, Bob and Sateesh.

**Operator**

The next question comes from Kudakwashe Kadungure of Investec Securities.

**Kudakwashe Kadungure**

Good day guys. Following up with regards to the mobile data ARPUs, about the smartphone ARPUs, how has that trended from last year to the current period? And the second part, your M-PESA margins, what is the uplift that you are seeing following the new license agreement with Vodafone? Thank you.

**Sateesh Kamath**

I will take the ARPU question first. As an extension of what I was explaining to Eric earlier, we see a significant increase in volumes. The average consumption per data subscriber is now 250 MB per month which is a 44% increase year over year. Mobile data has also gone up significantly by 21% year over year. So that is the mobile data question.

**Bob Collymore**

The impact of the reduced [unclear].

**Sateesh Kamath**

We moved to the new contract. The license fee has now come down to roughly 5%. It used to be around the 10% mark before we did the migration.

**Bob Collymore**

Impact on margin.

**Sateesh Kamath**

There is a 5% impact on M-PESA margin directly because it just flows through into the bottom line.

**Kudakwashe Kadungure**

Thank you.

**Operator**

Thank you very much. Gentlemen, that was the final question. Gentlemen, we have no further questions from the lines.

**Gregory Waweru**

Bob, Sateesh, perhaps any final closing remarks?

**Bob Collymore**

Like I said I think we are pretty confident about the remainder of the year. The question I guess some of you guys will ask when we see you is the broader outlook around the economy, around the elections next year. I think we are pretty confident around elections. We think there will be a little bit turbulence because African elections tend to be. But I don't think there will be any major impact. We are seeing quite a lot of confidence in the country. Again you will know that as much as I do. I think there is a dividend which is flowing into Kenya from the challenges in some other African countries. The interest rate capping Bill I think was a little bit unfortunate and I think that will have a dampening effect on some sectors of the economy, obviously the

banking sector but also some of the small medium-sized businesses might find it a little bit difficult to raise capital. But again we don't really see that having much of an impact. So we remain confident in our guidance for the second half and we look forward to seeing many of you on the road show.

**Gregory Waweru**

All right. Thank you very much ladies and gentlemen. Over to you, Judith.

**Operator**

Thank you. On behalf of Safaricom and SBG Securities that concludes this afternoon's conference. Thank you for joining us. You may now disconnect your lines.

END OF TRANSCRIPT