Consolidation in Kenya's Banking Sector to Continue, & Cytonn Weekly #06/2019

Private Equity

Kenya's second and third largest telecommunication companies, Airtel and Telkom, announced the signing of a binding agreement that will see the shareholders of the two companies merge their respective mobile, enterprise, and carrier services businesses in Kenya to operate under a joint venture company. Although still in its early stages, the following has been disclosed regarding the transaction:

I. The merged entity will be named Airtel-Telkom,
II. The merged company will be chaired by Telkom Kenya Limited's current CEO Mugo Kibati, while Airtel's CEO Prasanta Sarma will be appointed CEO of the merged entity,
III. Telkom Kenya Limited's real estate portfolio and specific government services will not form part of the combined entity, and,
IV. The final shareholding will be determined at the closing of the transaction with Telkom Kenya having the option of holding up to 49.0% of the merged entity.

We expect this merger to have the following effects on the Kenyan telecommunication space: (i) Subscriptions / Voice Market Share is expected to be split between two major players with the merged entity set to increase its share, (ii) The combined entity will command a market share of 29.6%, (iii) Airtel will make an entry into the fixed data services market, and, (iv) Mobile Money is least likely to be affected given that neither of the two merging entities have a significant share in the market. The overall effect to the market is that we will now have a company that has scale to provide a credible market alternative to the currently dominant Safaricom.

In terms of the detailed effect, we expect the below:

1. **Mobile Subscription: Overall market share of the merged entity will increase**

According to the Communication Authority's sector report for September 2018, the number of active mobile subscribers (number of active sim cards) stood at 46.6 mn translating to a mobile penetration rate of 100.1%. As at September 2018**,** Safaricom Plc had the largest market share by mobile subscriptions at 64.2%, whereas Airtel posted a market share of 22.3%. Telkom Kenya Limited recorded a market share of 9.0%. If the merger is successful, Airtel-Telkom (the merged entity) will have an effective market share of 31.3%. This should have a positive development in the market because we should have a second player with scale competing with Safaricom and providing a credible alternative to Safaricom.

Network	Subscribers	Mkt Share
Safaricom PLC	29,943,641	64.2%
Airtel Networks Limited	10,413,732	22.3%
Telkom Kenya Limited	4,188,517	9.0%

Network	Subscribers	Mkt Share
Other	2,084,272	4.5%
Total	**46,630,162.00**	**100%**

Network	Subscribers	Mkt Share*
Safaricom PLC	29,943,641	64.2%
Airtel-Telkom	14,602,249	31.3%
Other	2,084,272	4.5%
Total	**46,630,162.00**	**100%**

Proforma market share

2. **Mobile Data Services: The merged entity will command a market share of 29.6%**

Data services in Kenya are classified as either mobile or fixed data with the number of subscribers as at September 2018 indicated below:

Internet Subscriptions	Subscribers
Mobile Data Subscriptions	41,854,706
Fixed Data Subscriptions	349,797
Total	**42,204,503**

In terms of market share, the mobile data market is as follows:

Mobile Data	Subscribers	Mkt Share
Safaricom PLC	29,416,539	69.7%
Airtel Kenya	9,242,786	21.9%
Telkom Kenya Ltd	3,249,747	7.7%
Others	295,432	0.7%
Total	**42,204,503**	**100.0%**

Source: Communications Authority

Market share of mobile data services is proportional to that of mobile subscription. If the merger is successful, the mobile data market will be dominated by 2 parties (Safaricom and Airtel-Telkom) controlling nearly 100%, as shown below:

Mobile Data	Subscribers	Proforma Mkt Share
Safaricom PLC	29,416,539	69.7%
Airtel-Telkom	*12,492,533*	*29.6%*
Others	295,432	0.7%
Total	**42,204,503**	**100.0%**

3. **Fixed Data: Airtel will look to tap into Telkom's existing infrastructure**

In fixed data, the market is more competitive with Wananchi Companies Ltd having the largest share at 39.2%. Key to note is that Airtel has no significant share in the fixed data market. We expect this will be one key area that they will be looking to tap given Telkom's current infrastructure.

Fixed Data	Subscribers	Mkt Share
Wananchi Companies Ltd	137,213	39.2%
Safaricom PLC	96,608	27.6%
Jamii Telecommunications Ltd	45,933	13.1%
Poa Internet Kenya Ltd	26,726	7.6%
Internet Solutions Kenya Ltd	15,074	4.3%
Mawingu Networks Ltd	13,128	3.8%
Liquid Telecommunications Kenya Ltd	8,234	2.4%
Telkom Kenya Ltd	*3,801*	*1.1%*
Other	3,080	0.9%
Total	**349,797**	**100.0%**

Source: Communications Authority

4. **Mobile Money Services: The merged entity will struggle to gain mobile money market share**

We expect this to be a key area of focus in terms of strategy for the merged entity. As at September 2018, the mobile-money market was as highlighted below:

Platform	Agents	Active Subscriptions	No. of Transactions	Value of Transactions (Kshs)	Mkt Share*
M-pesa	162,800	24,206,341	575,660,251	1,585,729,101,317	78.20%
Equitel Money	-	1,992,150	149,463,508	439,188,528,611	21.70%
Airtel Money	27,267	3,434,843	4,628,370	1,153,142,919	0.10%
Mobile Pay	6,890	92,122	354,565	1,379,068,293	0.10%
T-Kash	21,538	59,933	104,833	197,106,156	0.00%
Market	**218,495**	**29,785,389**	**730,211,527**	**2,027,646,947,296**	**100.0%**

***Market share by value of transactions**

Source: Communications Authority

After the merger, the merged entity (Airtel money and T-Kash) will have a wider distribution network in terms of mobile money agents as highlighted below. This is expected to accelerate the number of active subscriptions and, in turn increase its market share.

Platform	Agents	Active Subscriptions	No. of Transactions	Value of Transactions (Kshs)	Mkt Share**
M-pesa	162,800	24,206,341	575,660,251	1,585,729,101,317	78.20%
Equitel Money		1,992,150	149,463,508	439,188,528,611	21.70%
Airtel-Telkom	*48,805*	*3,494,776*	*4,733,203*	*1,350,249,075*	*0.10%*
Mobile Pay	6,890	92,122	354,565	1,379,068,293	0.10%
Market	**218,495**	**29,785,389**	**730,211,527**	**2,027,646,947,296**	**100.00%**

*****Proforma Market share by value of transactions***

Source: Communications Authority

Overall, we expect the merger to greatly benefit both parties since Airtel and Telkom combined leads to a player with scale to compete with Safaricom, and most importantly for the market, if the integration is well executed, it provides a credible alternative to the consumer. However, Safaricom's dominance is still expected to remain given its commanding presence in all the channels analyzed.

Reports Released:

African Private Equity and Venture Capital Association (AVCA) released two reports after completing two sets of surveys on institutional investors in Africa. The reports are:

i. The 2018 Annual Limited Partner (LP) Survey, a study that analyses the plans, views, preferences, expectations and evolving attitudes of 60 Limited Partners (LPs) from Africa, Asia, Europe and North America regarding Private Equity (PE) in Africa, and,
ii. The 2019 Profile of Africa's Institutional Investors, that maps the different pools of capital for African private equity. It also gives an overview of the demographics of institutional investors with allocations to Africa.

The 2018 Annual Limited Partner (LP) Survey

According to the report:

1. LPs' appetite for African PE has remained steady, with 53.0% of LPs planning to increase their PE allocation on the continent over the next three-years. This is 1.0% point lower than the sentiment expressed in the 2017 survey,
2. In terms of preference, 65.0% of LPs view Africa as more attractive for PE investment than developed markets over the next ten-years,
3. Overall, most LPs believe in the medium to long term attractiveness of Africa compared to developed markets,
4. Regionally, Nigeria is viewed by majority of LPs as the most attractive country for PE investment in Africa over the next three-years with a popularity index ranking of 58.0%, followed by Kenya (40.0%) and Egypt (31.0%), and,
5. By sector, Financial Services is identified by LPs as the most attractive sector for PE investment in Africa over the next three-years with a popularity index score of 51.0%.Other sectors viewed as attractive include, Consumer Goods, Agribusiness, Healthcare and Education.

Profile of Africa's Institutional Investors

1. The report sorted the institutional investors by type. Of the institutions surveyed, 29.0% were Development Finance Institutions (DFI), 25.0% were pension funds and 15.0% were third party

fund managers,

2. Majority of the institutions are European based with 36.0% having their head offices in Europe while North American based institutions came second at 32.0% of the total. Africa based investors were 31.0% of the total,
3. By regional focus, 63.0% of the directory population indicated that they have a pan-African geographic focus, while 18.0% claimed to have Sub-Saharan African focus, and,
4. In terms of investment strategy, growth equity is the most popular investment strategy for the directory population with a popularity index of 93.0%, while venture capital and mezzanine finance scoring 64.0% and 63.0%, respectively.

Takeout:

Investor sentiments analyzed from both reports are in line with our general outlook for private equity in Africa as analyzed in our Cytonn 2019 Markets Outlook and are summarized as follows:

i. Private equity in Africa remains attractive as witnessed by the positive investor sentiment, with Nigeria being the most favored destination, followed by Kenya and then Egypt.
ii. Nigeria, recovering from recent recession, remains Africa's largest private equity market in terms of deal volume. We expect its recovery to boost the private equity space even further.
iii. Kenya has been fortunate not to face economic headwinds as was the case in Nigeria and South Africa, the two most developed African PE markets. As such, Kenya has gained ground on its counterparts and we expect this trend to continue in 2019.

Foreign players remain an integral component of PE activity in Africa and we expect foreign direct investments to continue defining Africa's private equity space.

We maintain a positive outlook on private equity investments in Africa as evidenced by the increasing investor interest, which is attributed to; (i) economic growth, which is projected to improve in Africa's most developed PE markets, (ii) attractive valuations in Sub Saharan Africa's private markets compared to its public markets, and (iii) attractive valuations in Sub Saharan Africa's markets compared to global markets. Going forward, the increasing investor interest, stable macro-economic and political environment will continue to boost deal flow into African markets.