

# Conference call transcript

22 June 2020

## ANNUAL RESULTS ANALYST CALL

### Operator

Good afternoon ladies and gentlemen and welcome to the Telkom annual results conference. All participants are currently in listen only mode and there will be an opportunity for you to ask questions later in the conference. If you should need assistance during the call please signal an operator by pressing star and then zero. Please also note that this call is being recorded. I would now like to turn the conference over to Siphso Maseko. Please go ahead, sir.

### Siphso Maseko

Thank you very much, Chris. Good morning to everyone in the US and good afternoon to everybody else. With me I have our group CFO, Tsholo Molefe, and our head of IR, Babalwa George. I will dive straight in and make an attempt to unpack our annual results performance as follows. I will speak a little bit about the strategic themes that are underlying in the annual results performance. Tsholo will then unpack the financial performance a bit more. I will then come back addressing the regulation environment as the country prepares for the release of spectrum on a permanent basis. I will also share how we are thinking about unlocking the value trapped in our portfolio of businesses. I will also conclude by sharing the impact of COVID-19 on our business and how we responded to it in relation to our employees, our customers, managing the demand within our existing infrastructure, as well as how we have supported government in the overall response to COVID-19.

I'll start by saying that today we announced the delivery of an encouraging annual set of results that actually demonstrated trends that are encouraging in a very, very difficult economic environment. The country, if you recall, slipped into a technical recession, and secondly, we were not spared the global pandemic of COVID-19. This year in particular also concludes a very challenging decade of a very, very depressed economic growth, currency volatility, massive technology changes, increasing competition in the market, and a regulatory environment that was uncertain. And all of these, as Telkom, we were not spared from.

However, I must say that despite these challenges relating to the operating environment, the results are pretty solid. Notwithstanding the decline in the fixed voice revenues which impacted the group EBITDA earnings negatively. And maybe just to mention a couple of highlights. Our mobile business remains the fastest growing mobile business in South Africa with service revenue growth of 54% supported by a net customer addition of about 1.9 million, which takes us to a 12 million number of subscribers at a blended ARPU of about R91, which is actually the highest in the industry. We continue to gain customers and revenue share from our peers.

The second highlight is in relation to our connectivity rate with fibre to the home. It remains the highest in the market at about 48% of homes connected relative to homes past. Our free cash flow of R2 billion is three times higher than the previous year and the swing of R3 billion from the first half of the year where we reported a negative free cash of about

R1.2 billion. And Tsholo will spend a bit of time really unpacking all the initiatives that we put in place to ensure this structural change in our free cash flow generation. One of the highlights is that our balance sheet was strengthened with a net debt to EBITDA of less than 1x. Tsholo will also unpack the balance sheet later on.

There were four strategic themes that underpinned our annual results. Number one, our infrastructure investment is yielding positive results. Number two, broadband leadership being attained across the broadband ecosystem. Number three, the evolution of the fixed voice business. And last but not least, the mobile business growth. And maybe let me start with the infrastructure investments and how these are yielding the results that we are looking for.

Over the past few years we've been investing a lot in our broad infrastructure. Now, this includes having an all IP fixed and mobile network, data centres, masts and towers. In the current year our capital investment of about R7.8 billion with a capex to revenue intensity of 18% in the period was to increase coverage and capacity of our mobile and fixed business. fibre backhaul, 5G small cells, automating data centres, and as we speak today, we have three out of four tier 4 data centres in Africa. And you would have seen some of our references in terms of data centre services as well beginning to make a positive contribution underpinned by hybrid cloud.

Whilst we invest in our infrastructure, we also focused on commercialising our assets to monetise our capital investment. COVID-19 pandemic is also having the effect of fast tracking digital transformation in companies. And we see this in a sense also partly as an opportunity for Telkom to commercialise all of its asset classes. Our ongoing investment in new revenue streams has enabled the group to grow operating revenue in evolving technology where our traditional revenues are shrinking. I'm truly pleased that our operating revenue grew 3% to R43 billion, despite the fact that 22% of revenues that we saw declining in our fixed voice business. Our ability, therefore, to grow operating revenue in the face of these challenges bears testimony to the success, as I indicated, of our infrastructure investment beginning to bear the right outcomes.

And then you might ask, this investment in infrastructure, it's to what end? And this takes me to the second theme, which is a broadband leadership being attained across the entire ecosystem. So we continue to execute on our overall strategy with regards to data, both fixed and mobile. We remain the leader in the fibre industry with a national fibre network of about 164,000 kilometres. Maybe talking about traffic. Fixed traffic went up about 11.5% supported by roughly about 724,000 fixed customers. I mean, in fact there's a statistic which one of my colleagues gave me today. Ordinarily we would get roughly about 5,000 fixed orders a month and actually on Friday they had 1,000 orders just for Friday. And so we're beginning to see the uptick and the demand around fixed services beginning to come through. Now with this fixed data traffic up it was also augmented by traffic for fibre to the home and fibre to the base station.

I've already mentioned fibre to the home connectivity rate improvement. Last year, same period, it was 38%, this year is 48%. It's the highest in the market and we continue to really focus on that, so that we can have as much of our capital deployed in that area beginning to remunerate the investment that is being made. Fibre to the business is up about 26% and fibre to the base station up about 9%. So that's on the fibre bit.

When it comes to mobile, our broadband propositions continue to resonate with customers. Mobile data revenue grew about 46% to R8.7 billion. And this is supported by roughly a 28% increase in mobile broadband customers. Now, approximately 70% to 80% of our active mobile customers are using data. And that's informed by the all IP network that we've built, fixed and mobile, and also the data led propositions that we continued to launch in the last couple of years.

We have also re-farmed a significant portion of our 1800 MHz spectrum and also started re-farming portions of our 2100 for both LTE and LTE-Advanced to cater for the data traffic. Mobile traffic, as I indicated in the presentation in the morning, the traffic grew by about 69%. So thus we will continue to drive aggressive broadband growth, accessing all the untapped segments, leading with high speed mobile with an option to switch over to fibre. So that's the second theme really, how do we continue to attain a leadership across the broadband ecosystem?

The third theme that is underlying in our results is around the evolution of the fixed business. We operate in a business environment that's constantly evolving. Advances in technology and changing customer needs obviously would impact traditional revenue streams. And thus we need to transform the business with a view for long-term growth. However, one of the things that we have seen is that our traditional fixed voice business has continued to decline. And this is impacted obviously by these technology changes and it's in line with global trends. And these fixed voice business revenues a high margin traditionally.

I mean, although our multi-year transformation program has reduced our legacy fixed voice revenue contribution to the group from roughly about 56% in 2013 to about 20% this year, the impact on group EBITDA is still high and could not be offset by new revenue streams for now. And if you had to kind of think back actually, if we did not have a mobile business, and actually if we did not have an IT business, this picture would look even more depressing because we would have no alternative revenues that would be offsetting the decline in legacy fixed voice contribution [unclear].

We therefore expect fixed voice revenue to continue to decline, driven by usage as people work from home. But we also believe that data is expected to pass any offset the impact that this environment presents an upside to the offset by data fixed or mobile. The contribution of fixed voice will decline from a lower base while the contribution of the mobile business is expected to increase from a higher base, offsetting this decline. In the last two months of April and May we continue to see our mobile business holding on the trends that we saw – in fact, actually, when the lockdown started we all of a sudden began to get quite an increased number of enterprises who were looking for either LTE solutions or fibre solutions for their employees that they were moving to work from home. And we see this actually as a potential gap for us to be able to access what we call enterprise revenue, leading with data for employees as work persons and study persons begin to change. However, until that inflection point at EBITDA level is reached, we will continue to focus on ongoing sustainable cost management to close the EBITDA gap.

We initiated the first phase of a two phased process around staff optimisation. Last year, therefore, we took a charge of approximately R1.2 billion insofar as that is concerned. We also announced obviously the beginning of the second phase which we will execute only in the second half of the year. So that has been the third theme, the evolution of the fixed business driven by technology changes and in particular as it relates to copper.

The fourth theme is around mobile business which has been driving growth and continues to drive the growth. Furbished revenue of the mobile business went up by about 54% to about \$12.5 billion. Rands not dollars. I wish it were dollars. Which is an increase of about R4 billion. What is behind this, what supports it? Customer growth of about 24%, ARPU growth of about R91 as our affordable data-led products continue to resonate with our customers. Prepaid subscribers grew about 21% with a net addition of about 1.6 million subscribers to about 9.4 million. Though prepaid ARPU declined by 8.2% to R66 compared to the year before, this is a slight improvement compared to the first half of the year as we address some of the distributors that we had who were acquiring very, very low value customers and also driving firm [?] in our customer base.

We also saw good growth in post-paid segment as well, increasing by about 36% with a stable ARPU of about R188. Post-paid ARPU trends have improved following a 7% decline in the first half of the year and we still believe these will continue to hold. Yeah, we noted changes in pricing by our peers. We have not seen any impact in our business. We believe that our broadband propositions remain best in the market despite these changes. We have a data-led network. We have the right broadband propositions. We've used the spectrum that we have, I think, very, very smartly. We've installed as much fibre to the base station for backhaul as much as possible because most of our customers from the very beginning were skewed towards data and we believe that this recipe will enable us to withstand the intense competitive landscape going forward.

We've made significant strides as well in enhancing the mobile profitability. Three years ago or so, I think the margins were roughly about 1%. Now it's at about 15% and if you use IFRS, this would be at about 18.5%. We are comfortable that our mobile business will be operating in the 20% to 25% EBITDA margin corridor in the foreseeable future, offsetting the decline in fixed voice. The team continues to really drive hard every opportunity of efficiency and actually with COVID, we

are starting to rethink a lot of things 100%. If, for instance, we are stuck in this COVID environment for the next 18 to 24 months, actually do we need stores and how do we use this as an opportunity to change customer behaviour so that we drive them to digital channels as hard as we can? So based on our revenue market share estimates, Telkom Mobile will be the number three player in South Africa in the next 12 to 18 months. I will now let our group CFO unpack the financial numbers for you and then I will come back and conclude post that. Over to you, Tsholo.

### **Tsholofelo Molefe**

Thank you, Siphos. Thank you ladies and gentlemen. I will unpack the key financial messages. I think what is important before I go into the detail is to really just highlight some of the exceptional items that impacted on our financial performance this year. Firstly, the adoption of the new accounting statement on leases. IFRS 16 boosted our EBITDA by about R1.1 billion but the impact on earnings overall was immaterial. Secondly, the charge that we took relating to the restructuring of about R1.2 billion had a negative impact on EBITDA. We also had to account for additional impairment of trade receivables, really taking a prudent approach to take account of the COVID-19 impact and we raised an additional provision for bad debts of R626 million and this was in addition to the normal provision for bad debts of about R514 million.

If I then just unpack our underlying performance which excludes then the impact of these once-off and exceptional items, I think firstly, on our revenue, we can see that we grew revenue by 3% to R43 billion largely driven by mobile which continues to be the driver of growth. However, this was offset by the decline in our fixed voice revenue of about 22% as alluded earlier. The mobile business growth was really underpinned by our ongoing capital investments and the mobile broadband propositions that we continue to see resonating with customers in that area.

It is also pleasing to see that all the new revenue streams grew, contributing positively to overall group revenue. Despite the challenges that we are seeing in the economy where BCX mainly, our ICT business operates, with the country slipping into technical recession in the fourth quarter of the year, the external IT business revenue grew by about 1.8%. Gyro also showed good growth from the mast and tower portfolio with external revenue increasing by about 7% as the demand for external leases increased. So the challenges that we faced really was the impact of the fixed voice decline on our group EBITDA. The decline in this fixed voice revenue of approximately 22%, as I indicated, was offset by the significant growth that we saw in mobile.

From a cost perspective, management continued to really focus on cost containment and we saw our group operating expenses really growing below inflation at about 2.5% growth year on year. We are also able to optimise on our direct costs, particularly relating to the mobile business, where we saw an improvement, firstly, from the first half of the year from a mobile direct cost to revenue ratio of 52.6% to now about 44% in the second half of the year and we will continue with the initiative that we embarked on to ensure the sustainability of our mobile business. However, the extent of this decline in our fixed voice on group EBITDA was really not offset yet as our fixed voice are high margin, therefore resulting in a margin pressure from an EBITDA perspective with absolute EBITDA declining by 8.7% from the previous financial year.

If we then look at our group earnings which were really impacted as well by these once-off items that I referred to earlier, we saw that our reported headline earnings per share and the basic earnings per share were down 66% and about 78% respectively and these were due to the restructuring charge that we took that I referred to earlier on of about R1.2 billion, the regional impairment on receivables of about R626 million. These once-offs which are really not deductible as well from a tax perspective and we saw the group profit before tax as well increasing from an effective tax rate perspective, from a statutory 28% to 37.6%. Underlying performance, therefore, which excludes the once-off costs relating to the restructuring programme and these additional provision for bad debts impacted earnings by about 262 cents. So your underlying headline earnings per share as well as your basic earnings per share actually declined by 30% and 37% respectively.

If we now move on to the free cash flow, as we indicated we've seen strong improvement in our free cash flow compared to the previous financial year. If you recall at the interims we did announce that we would be seeking to put in place some cash relief initiatives, really focusing on our working capital improvement. We said that we would focus on supply chain financing which is in relation to our trade payables. We said that we would look at some opportunistic disposal of non-core

assets in areas where we could. We also said that, given that our post-paid book we recover the cash from the customers over 24 months, we would also be seeking to look at handset receivable financing.

So we are pleased to announce that with the efforts that we actually made in the second half of the year, we were able to actually put in a lot of measures in place and if I can take you through some of these achievements firstly that we've made. Firstly, we were able to collect close to about R800 million more than we expected from our customers but this was slightly offset by some of the real provisions that we saw in the BCX environment as customers, some of the enterprise customers, are in distress. So overall our cash collection on a net basis were about R667 million as an improvement.

So in line with best practice as well, we also reviewed some of our standard supplier payment terms in the current financial year and this, I indicated, was part of our cash relief initiative and we did a lot of work, actually, when we were reporting at interims, just looking at how to improve our trade payables. We have actually been lagging behind the curve relative to some of our peer groups. So this is really a permanent change. It is a structural change. The payment terms are now 90 days and really we make it available for suppliers that require it and those that want to require immediate cash, we then establish a supply chain financing tool for them. So we did not actually defer the creditor's payment to reflect positive free cash flow but this is really rather a real improvement in working capital in looking at how we pay our suppliers. And also if you take into account what I said earlier on that your customer collections, particularly from a post-paid perspective, takes about 24 months with regards to customers that have devices, you therefore have to make sure that you can protect your liquidity and cash by making sure that structurally you make those changes to be able to free up your cash.

So overall we are quite comfortable that these payment terms, obviously we've changed the payment terms and we've been able to improve on our payments with suppliers and it's really a rigorous process that we actually go into with our main suppliers that have long term contracts with us and as a result, those trade payables improved by about R1.9 billion year on year and we will continue where we see opportunities into the future with these efforts that we are making. We are still to do the handset receivable financing with some of the potential financial services companies and we'll be able to see, obviously particularly under the COVID environment, what can be done. There are still also opportunities from an inventory management as we move forward into the new financial year.

So as a result of the strong free cash flow improvement, we saw that our balance sheet also strengthened during the year. We were able to pay down debt of about R1.2 billion after increasing our borrowings in the first half of the year by about R1.8 billion. So as a result of that, our gearing improved since the first half of the year with our net debt to EBITDA now excluding the impact of IFRS 16 reducing to 0.7x from about 0.8x last year and about 1.3x including IFRS 16 as an improvement and this is within our guided 1.5x including the impact of IFRS. We've also extended the maturity profile of our debt book to reduce the refinancing risk that we're seeing and we're comfortable as well that we have sufficient balances, sufficient facilities, going forward to be able to weather the storm going forward. So we have facilities to the value of about R5.7 billion in terms of committed facilities with various banks.

So the board declared also a final dividend in line with current dividend policy of about 50 cents, so of 60% to headline earnings which is a pay out of about 50 cent for the final dividend. Telkom indicated in the first half of the year as well that we would be seeking to review the dividend policy and that in considering the new dividend policy we would prioritise our capital investment program where we are seeing good returns and good growth into the future while at the same time being able to maintain a healthy balance sheet and consider the cash position, particularly within the current environment of COVID. The spectrum option that is imminent as well will require substantial amount of capital and it is of strategic importance to us to be able to participate and ensure the sustainability of our mobile business. At the same time preserving cash and maintaining a flexible balance sheet as I indicated has become quite critical under these conditions as the economy is under strain.

So given all these factors and also the fact that we would be making payments for the restructuring program, Siphos indicated we're doing phase one and phase two. Phase two of which we expect to start rolling out in the second half of the year and that would also require some capital. So given all these factors that are expected to obviously have an impact on

our numbers, we found it prudent to suspend the dividend policy from the new financial year, over the next three years. Obviously, if things change and we see that we have surplus cash, we would obviously review the decision that we have made on the dividend policy. We also had issued a medium term guidance commencing in 2019, with the financial year 2018 being the base year of that three year guidance.

So the financial year 2020, was the second year of the guidance where we experienced a challenge in terms of meeting the EBITDA target largely due to the fixed voice decline which has high margins. However we see that we have performed well in line with the guidance expect for the EBITDA. So top line growth overall, we are within guidance on a compound average growth rate when you look at the two years we're able to meet the net debt to EBITDA, we've been able to keep our CAPEX intensity as well within the 16% to 20% really having seen a reduction as well since 2018 from about 20% to now 18%. In addition, I think the lockdown response to COVID-19 as well pandemic is expected to impact the South African economy significantly and therefore quantifying the likely magnitude of this crisis also is quite challenging at this point in time.

So different sectors within the economy obviously are suited differently to continue operating under the different lockdown phases. So based on all those sectors that we've taken into account, we felt it prudent to suspend the guidance for the financial year 2021 and obviously once we know what the impact of COVID would be and also some of the new products that we are introducing in the market to take advantage of the COVID, obviously we need to see how those materialise and therefore, we'll probably be able to give a better guidance to the market at the end of the year. Should we obviously see it much later, we'll then lift the suspension of the guidance. I will then know hand over to Siphso, just to conclude.

### **Siphso Maseko**

Thank you very much, Tsholo, for the update and in particular where as appropriate really making sure that we are very clear that [unclear] capital story. We were inefficient for lagging behind our peers and this move is in line with industry terms which is having the right supply chain management terms, having the right payment terms, improving collection and going forward, we will continue with handset receivables, financing and continue with supply chain management, further optimisation of that. As we are achieving scale in our mobile business, it gives us the ability to renegotiate quite a lot of services and terms that when we were a start up in mobile, it was very, very difficult for us to be able to renegotiate those and I think we're beginning to see our ability to reset some of those terms in some of our businesses. So perhaps maybe just to find a way in which we can wrap it up.

So clearly around the regulatory environment we've been engaging the regulators and the department around and policy makers to motivate for regulatory and policy certainty which supports fairness and encourages competition with long term benefits for consumers and the growth for South Africa. And it's a very, very important point for us that we will take down to the wire to make sure that spectrum gets released almost once every 25 years and we do know that once spectrum is released then the gain is set for the next 25 years. And we really want to make sure that during this window of spectrum allocation, it is not done in a way that entrenches [unclear] for the next 25 years. It is not done in a way in which competition is not encouraged for the next 25 years. So it's a big area of focus for us. The competition commission's enquiry in to the cost of data affirmed that the South African market has no effective competition and the recommendation resulted in a decrease in data pricing to benefit consumers and enable greater access. So much as we welcome the ruling that was made, but actually it needs much more than just reducing data prices.

We're actually saying that the next frontier is to make sure that how spectrum is therefore allocated, is not allocated in a way that entrenches the lack of effective competition. So we are absolutely convinced that we want to push for that and make sure that we continue to be well provisioned to offer the right value for broadband propositions in the market. The policy on high demand spectrum was published in the first half of year 2020. It helped with bringing some clarity. We will obviously wait for ICASA to give effect to the policy. We've seen as well an announced spectrum clearing agreement which in our view have changed spectrum access and it's one of the things which we would implore the regulator to take into account, in terms of how do they deviate [?] spectrum. They need to start reading some of these spectrum arrangements almost at once. The spectrum arrangement between Cell C and MTN should be read essentially as MTN having access to all

of the spectrum. And the spectrum arrangement between Vodacom, Liquid and Rain, should be read as Vodacom having access to all of the spectrum, in terms of how they use it and it's a very important point for us.

In April 2020, we were all granted [unclear] spectrum with these network concentration during the lockdown. We did benefit from that in terms of making sure that our areas of congestion are addressed, especially [unclear]. Obviously this is temporary and after the lockdown or in November this will be returned unless obviously ICASA extends it. We've also been very encouraged by the speed and deliberateness of government decision making during this time. Decisions have been made fast, we are hopeful that going forward as well, this will be a new cadence and it has shown that decisions can be made as long as there's clarity in policy and very, very clear outcomes that seek to be achieved, decisions get made and for us actually, it's been very encouraging to look at that. So I then proceed to value unlock.

So when we began the process of making sure that in our operating model, we set up these businesses as standalone businesses with a very, very clear profit accountability responsibility, is that it actually began to deal with some of the issues we had in the past of cross-subsidisation. Some of the businesses relying on being supported by other businesses. I mean we had a lot of these masts and towers, but actually, there was no fair value that was put in them because other businesses were subsidising others with using the same infrastructure and we think that we have largely achieved the journey that we began back in 2014. Gyro and BCX are essentially structurally separated. Openserve and consumer are functionally separated. We are in the process led by Tsholo and her team of completing the balance sheet split between Openserve and consumer, which will then naturally lead to structural separation of Openserve so that we then have the right level of flexibility for value unlock opportunity and complete the operating model.

And in essence what you will end up with is a very, very small cooperate centre, extremely small. You'll end up with four or so businesses or five, whatever number they are that need to be able to demonstrate relative to their peer group that they have strategic clarity, the tri-factor of scale growth and capabilities is met and then we begin to look at how we are able to then commence with the process of value extraction. We obviously in some instances the issue of scale and capability that hinders growth, we saw it in mobile, we are now beginning to achieve reasonably some scale of that enables us to do other things in the market. We acquired BCX and Jonas and his team are beginning to grow the cloud business and the IT solutions business, but in our considered view that as things stand, said the market cap is not a true reflection of the intrinsic value of the company, there's a massive valuation gap at the... EBITDA multiples of full year 2020, on an underlying basis, based on the sum of the past, we believe that there's a valuation gap of around 40 billion and we will explore ways to unlock this trapped value in this conglomerate structure starting most likely with the Gyro, masts and towers, going forward.

COVID-19, response and impact in the fourth quarter of the year, obviously, there was the pandemic spread which disrupted every aspect of our lives and business operations. Then a national state of disaster was declared in March, our sector was deemed to be an essential service and we have been doing quite a lot to provide support and keep connectivity. When the national command council meets and the cabinet ministers are having their own virtual meetings, we deployed fibre to many of their houses in record amounts of time and we've seen this [unclear] demand growing. We've obviously focused on our employees.

At the end of March we had approximately 80% of our employees already working from home. By the time level five was declared, that increased to about 94%, there or thereabout. We've seen a huge surge in fixed and mobile traffic during this time, people working from home and they're learning from home. And we have sufficient network and redundancy to manage the increase in demand, all of the investments we've made, modernising the network, fibre backhaul, strengthening the core network, parked [?] optical transport network, that has been absolutely worthwhile and provided resilient systems to support this growing demand. The mobile footprint was also improved with new sites and increased radio capacity on existing sites and where we had congestion, the temporary spectrum helped us achieve that.

For the lockdown we also scaled up a lot of our digital platforms. There will be some announcements made around Yep! which is an e-commerce platform. We scaled up our ability to use digital channels and online 24/7. And we've been able to do quite a lot with our logistics partners and our very own open serve in relation to fibre-based products. We also took advantage of our existing copper network. We launched broadband on copper services on [unclear] DSL using the spare capacity ports and essentially the spare capacity on the network all together because as people are looking for a stable internet connection whether it's 4 or 8 or 10 megabits per second on copper if they're able to get that, that is better than wireless and we've seen some stabilisation and we expect to see upside on fixed data revenue going forward.

We're going to be helping government a lot on a number of things, I mean really on a number of things. We're working with the Red Cross to support all of the unsung heroes or frontline healthcare workers that was our contribution. We developed their track and trace platform that we worked with the NICD and aggregating all of the stats that you see the minister announcing every day, we do that. And we help them indicate where most of the infections are coming from, what the movement looks like, what the spread looks like, we do that. And we help them indicate where most of the infections are coming from, what the movement looks like, what the spread looks like and this particular pandemic is quite real. But also our own employees have really come forward contributing within the company as well. And we've also given the public the opportunity to contribute as well through donations made by SMS.

So as we conclude at Telkom we embrace our new normal. We've come to terms with the fact that the pandemic has not just disrupted our lives temporarily but we also have the view that this is a beginning of a change in the way the world operates. We continue to do the best that we can, first and foremost, to continue to service our customers and help them navigate this particular issue. Some of them never had sufficient redundancy. Some of them print media companies just did not have any online presence. They didn't know how they will enable their employees to work from home. We had to process orders in the thousands just when the lockdown started as different companies were looking for solutions for their staff to be able to work from home.

And we think we are beginning to see a change in how broadband will become an even more permanent feature and digital services and online everything and therefore we prepare ourselves for that, we have braced it. We also see it as an opportunity to restart our cost-base even more. We ask ourselves will we go back to our office, do we need all of the people that we had, do we need all of the stores that we had if actually we are still able to see enough sales coming through digital channels. So we continue to ask the uncomfortable questions so that we continue to push the business for it to stabilise at the right point where we think it potentially can get. So it's been a very, very long presentation for our callers there and I hand back to Chris, the operator. My apologies for being cut out earlier on.

### **Operator**

Thank you very much sir. Ladies and gentlemen, if you wish to ask a question please press star and then one on your touchtone phone, you will hear a confirmation tone to note that you have joined the queue. If you wish to withdraw your question please press star and then two. Our first question is from [unclear] of Nedbank, please go ahead.

### **Question**

Hi Siphso, hi Tsholo. Firstly, congratulations on the good results. I've got three questions, if I may. I'll start with the first one on the balance sheet. I don't know if you can share with us on colour what the impact would be on the handset financing, how that will affect your net debt. And if you can give us some colour post paying the voluntary severance and all the other matters that you've done post your end, where is net debt sitting at now and what is are you expecting it to be at interim. Two other questions I've got are on the phase two of the headcount restructuring. Can you share with us any potential figures of what that may run into? The third thing is on the multi-links issue. You mentioned that you made a partial payment already to SARS and I think it was R300 million, I just want to know if you can give us some colour on what is still... I know you provided for it in prior period but what could be the potential cash outlay for that the rest of the year? Thank you.

### **Tsholofelo Molefe**



Thank you. I think I will take probably all the questions. So the handset receivables we haven't been able to implement yet. We have, however, made some good progress with one of the banks. I think when we went into lockdown obviously some of the banks wanted to see what does it mean from a customer behaviour perspective because, obviously they priced in a credit-risk premium in there. However, what we do is we actually assess it against our own average cost of borrowing. It is an off balance sheet, it improved your working capital but it's not yet in the numbers. Your other initiatives, however, that we were able to deliver on at year end they were factored in and hence the improvement in our balance sheet.

That's why we were actually able to pay down debt of R1.2 billion instead of refinancing. So that enabled us to therefore improve our net debt to EBITDA and that if you exclude the impact of IFRS and that add 0.7 times from 0.8 times last year. If you recall we had actually increased it at interim and I think we reported 1.2 times excluding the impact of IFRS. With IFRS impact it was around 1.4 times and we had revised the market guidance to 1.5 times. Going forward, obviously, we are continuing with these initiatives if we exclude the impact of all these payments that we need to make, particularly the restricting, we are quite comfortable we should be able to contain it within the 1 times mark.

In terms of the phase two of the restricting we, obviously still have to do a lot of work. We have not consulted with labour in detail although we have announced it. So we're doing the work currently and we are seeking to implement in the second half of the year so we are not able to give numbers at this point. However it will be really focused on BCX and Telkom head office as well as all the support functions across the group. It will impact the FY2021 financial year, both the charge as well as the payment relating to that. And I think as we indicated, phase one we already paid for in April which forms part of the new financial year.

In terms of Multi-links, if you recall over the last couple of years we had indicated that we had fully provided for it on our financials and it was at around R1.5 billion. While we were going to court with SARS, obviously, we had been able to apply for a suspension of payment and from time-to-time SARS would request us to make some payments. So have been able to service the payment at this point in time. And it is in our booklet we have an outstanding amount of about R800 million. This is after making a payment of about R300 million in the last quarter of the financial year at 2020. I think it's important also to highlight that the court matter still continues. We have engaged quite expensively with our legal counsel and the matter has been put through the constitutional court for review as well on our side. So we do await that outcome. And at this point of time, obviously, SARS has asked us to pay now and argue later. And we are in the process of finalising payment terms with them.

#### **Question**

Thanks Tsholo. Comforting to know that net debt number going into interim is still going to be contained within that one times range. Thanks very much, again. Cheers.

#### **Operator**

Thank you. The next question is from John Kim of UBS. Please go ahead.

#### **John Kim**

Hi everyone. I just wanted to get a little bit more colour and detail with regards to the capex for the next two to three years. I understand the core network build out is two years further. But how do you think about where you are versus your targets on fibre station to the base station? And how will capex might progress in the next two or three years? Should we be thinking about this in either Dollar/Rand quantum or percentage of sales? Any colour you could provide would be helpful. Thank you.

#### **Tsholofelo Molefe**

So I'll start and maybe Siphon can add. We've always said that it was important to modernise our networks. So investments that we are making in our packet optical network transport we are almost complete with that investment phase, we are probably around 80% there. And I think in terms of what we had initially set out to do from a fibre to the homes perspective we also quite advanced in terms of that. I think what we are seeing actually now is that with the increased demand for

broadband particularly post COVID it really presents itself in terms of looking at additional fibre deployments. However we are thoughtful about that because we obviously wanted to make sure that we increased the connectivity rate. So if you think about historically the original plan was really to do as much LAN grab so we are now at just over 455 thousand homes past. And therefore we actually slowed down to make sure that we increased the connectivity rate.

I think as well because we've been able to improve our productivity so from a capital productivity perspective as I indicated in my presentation we've seen a 40% reduction in cost as a result of that. And I think that enables us as well to be able to take up a lot more than what we have with those productivity improvements that we've done. So overall, just from a capex perspective, I think what's important to highlight as well is that we'll be quite thoughtful about capex obviously we want to make sure that we can invest for growth to ensure sustainability over long-term. So from a mobile business, from a fixed broadband perspective as well we'll continue with those investments. But we'll be flexible, informed by how we see our revenue coming through particularly under these challenging times. And should we see that the revenues are probably not coming through as a result of the impact of COVID we'll then be flexible enough to cut back the share capex where we can.

**John Kim**

Okay, helpful.

**Sipho Maseko**

Very important to add to Tsholo's point, our capex spend on the project execution thereof is [unclear 00:58:50] depending on the sort of revenue transact we see we can be able to dial it up or down. Insofar as the big lumps of capex the fibre optical transport network 80% of that is broadly done. And we've actually, I think as we speak, the value of the benefit of that both in terms of the capacity that we are using but also our customers, the MNOs themselves, the increased capacity that they are asking for during this time. And then post that it will then be driven largely by fibres to the homes, fibres to the base station. In terms of the coverage that we have of our sites is still in the 70%. So even as we are adding sites we pull as much fibre to the base station as we can. And on the fibre to the homes side we are going to manage delicately the fibre homes passed and the homes connection ratio very, very delicately.

**John Kim**

Okay, helpful. Longer term what do you think is a fair estimate for EBITDA margin and the mobile business, longer term where should that stabilise?

**Sipho Maseko**

We're targeting between 20% and 25% in that area. I mean, if you think about it when we started out as mobile we go to a big retailer who would be distributing and helping you gain market share. The cost that they would put on us at the time we just did not have the ability to negotiate as entrants. But one of the things that we are finding now is that we are able to renegotiate some of those terms. So, as we achieve scale we are able, actually, to bring further our costs down across the different lines that we have. We're starting to have clout with device providers. So, what they used to charge us before we are able to negotiate better discounts. And even the component providers for the network we're starting to have an ability to really get the right price point. So, 20% to 25% is the corridor we are aiming for in the next 12 to 18 months and we'll see how that goes.

**John Kim**

And on the call this morning you talked quite a bit about the need for spectrum. What sort of headroom do you have on your Mobile Network capacity today and is it the optimisation of the backhaul that you're looking for with the further allocation in December or what is the primary use of the lots that you want?

**Sipho Maseko**

So, for us the first and foremost is the sub 1 GHz spectrum for us because that gives us a lot more coverage and that helps reduce the capex intensity. So, today we have to densify the network a lot because we don't have the low frequency spectrum. Sub 1 GHz spectrum will help us with that coverage capability. And then, in terms of 2,600 MHz and 3,500 MHz

that helps us with the capacity, two or three carrier aggregation capacity, to be able to deliver speed for customers as well. So, that's the dual use of spectrum that we are looking to use it for.

**John Kim**

Great and headroom on network currently?

**Sipho Maseko**

So, headroom on network...?

**John Kim**

Yeah. So, if the emergency spectrum goes back and the auction in December is delayed how much more traffic could you carry right now, congestion?

**Sipho Maseko**

We've switched off 2G everywhere else in this country except Gauteng. Hopefully by the end of July we would have switched 2G in Gauteng. We are re-farming 1,800 MHz and 2,100 MHz to be able to just use it for LTE and LTE Advanced, so we will have that headroom. And remember that we are using 2,300 MHz essentially as well as Broadband as a Fixed LookAlike. We are not using it for Mobile. And actually one of the things that COVID showed is that during the lockdown Mobile doesn't help you much in the sense that you are not mobile. So, you can't do a Teams call driving around or you can't do a Zoom call driving around.

Actually, Fixed becomes absolutely paramount to be able to do that. Whether you are using wireless broadband which is fixed look alike or you are using copper, or you are using fibre but in essence you need to be stationary in a house or at home, wherever you are to be able to use the service. And we actually then think that might appear a negligible issue but in itself is beginning to transform how people... Even if people are using their mobile devices, they are using an iPad or a laptop or a smartphone, but they are accessing that Broadband service essentially using a fixed technology. Whether it's Fibre with Wi-Fi in the home or they use LTE which enables multiple connections and multiple services that can be consumed in the home.

**John Kim**

Okay. Very helpful. Thank you.

**Sipho Maseko**

Thank you.

**Operator**

Thank you. Ladies and gentlemen, just again, if you wish to ask a question please press \* and 1. The next question is from Ziyad Joosub of Nedbank. Please go ahead.

**Ziyad Joosub**

Hi, everyone. Thank you for the question. Just one question please, on BCX. In your booklet you mentioned that there were marginal improvements in the public sector. If you just give a bit more colour on that and how you see those evolving. And then, also, through the lockdown on the private sector side in BCX if you could possibly give us an indication of highest demand evolving in the private sector for BCX over the past two months. Thank you very much.

**Sipho Maseko**

Yeah. Sure, Ziyad. So, a couple things. Let me start with the private sector. Actually, I mean, BCX demand on the voice side they would have been under a bit of pressure, fixed voice. However, many of their customers were asking them – I mean, large banks and media houses – guys, can you connect 3000 of our staff either with LTE or fibre and can you do that in two weeks' time? So, that was the first thrust of the demand that was coming from most of their clients. I probably was one of

the biggest salesmen. In fact they owe me a commission, Ziyad, the BCX guys during the time. So, many of their enterprises where looking for, firstly, the ability to setup their employees to be able to work from home. The second bit that their customers were looking for is, do they have sufficient infrastructure resilience to be able to move their services online? And hence, you see some of the IT solutions and hybrid cloud services beginning to be quite important to a lot of entities. So, that's on the private sector side.

On the public sector side actually it is largely no different. So, we do this for the National Department Health, track and trace. I personally have been on calls with probably about, of the eight or nine provinces, with more than half of them with regards to what it is that we can do for them, not just in so far as health is concerned because they are looking to manage the health dimension. But also, some of the issues around transport as they themselves are looking to digitise their services. I mean, just last week, I think, the Department of Health, Western Cape signed with BCX two weeks ago and a week after that Eastern Cape. And we have never been quite strong with the Western Cape Department. So, we are seeing COVID almost changing the ability to deliver different types of solutions over and above connectivity.

**Ziyad Joosub**

Thank you very much. Thank, you Sipho.

**Sipho Maseko**

Thanks, Ziyad.

**Operator**

Thank you. The next question is from Dilya Ibragimova of Citi. Please go ahead.

**Dilya Ibragimova**

Hi, thanks very much for the opportunity. I had a couple of questions, the first is one data centres which you mentioned, I think you have three out of four tier 4 data centres in the country. Could you give us a bit more colour in terms of capacity that you have in total and maybe how much of the capacity is fair either in terms of number of RECS [?] or in either terms? And also, where these data centres are fitting within the business, is it part of Openserve or is it a separate business unit or maybe it's somewhere between Openserve and BCX? Just to get some understanding or whether you have separate plans to separate them out, to drive maybe take up of the services. Sorry, a number of questions on data centres.

And the second question is on mobile. How important is the customer growth for you going forward? I understand that some of the slowdown in the customer growth in the second half was to do some to some of the renegotiation of the terms with the commission-related terms which you mentioned now you have better scale and that's why you can reduce the scale. Yeah, maybe just colour whether that is still an important API for you and whether you see that going forward. If you have any comment there that'd be great, thanks.

**Sipho Maseko**

Sure. That's fine. I mean, I'll start with data centres. We have roughly about three tier 4 data centres, as I've indicated. About 12,500 square metres of data centre capacity. One is in Belleville. One is at Hartebeesthoek. One is in Pretoria. And then, I don't have the actual detail with me in terms of RECS [?] but they are able to hybrid cloud which means that we work with Azure, AWS, Cisco. So, we have cloud agreements with different cloud service providers. We have analytics driven operations and we are able to manage and host quite a lot of these. As our customers are moving to utility based business models where applications and services are consumed on digital platforms we have sufficient capacity to be able to acquire them. And remember that cloud consumption can also be on premise or on our own cloud. Public cloud versus private cloud.

And different customers begin to ask for different solutions and a software defined architecture. Just the demand for cloud services and even just pure data centre services. Remember that we are offering more a service rather than just a rental. One of the existing issues is that we are moving the infrastructure, so the asset class we are moving it to one of the business

units which is Gyro. So, Gyro essentially will have three asset classes and because they are essentially an infrastructure business, Masts and Towers, Properties and Data Centres which they will then open them up not just to BCX but also begin to open them up to other service providers who'd want to have access to the premises, which then in essence really positions it very well. Firstly, Gyro would have BCX as an anchor tenant in those data centres to provide different kinds of service but also have the flexibility to actually attract other potential tenants exactly as we're doing in masts and towers. So, that's on masts and towers.

In terms of mobile, I mean, it's profitable growth that we are after rather than just numbers or subscribers for the sake of it. So, I look at a couple of things with Tsholo. We obviously look at new subscribers, we look at terms, why are losing these customers and we look at whether, is it a distribution chain induced churn as well. We are migrating quite a lot of our acquisition to our own digital platforms. Instead of using intermediaries we are renegotiating things like the incentive schemes when new customers are being acquired. We really also seek strategic alignment between ourselves and the distributor in terms of where we're going.

I mean, it's a very, very important metric for us and for mobile as they are looking for how do we enhance the value from existing customers, number one. But number two, how do we make sure that we use what our in-boxing language. A combination of your left hand and your right hand to acquire the customer relative to the competition using either LTE or mobile or fibre which we have in our arsenal. So, growth is important, but margins are becoming even more important. And we're quite thoughtful in terms of the cost at which we make and that is why we've actually walked away from some of the deals, actually.

Some of these deals with some of the universities where they want you to provide them with data at ridiculous costs we sort of say no. Good luck. So, if somebody else will sell you at R0.03 a MB we're not going to do that. So, we are at a position where we can walk away from unprofitable arrangements on the Mobile side because we're quite conscious of the costs that you will load onto the network if you have unprofitable traffic that we bring on. And the consequence potentially of losing your profitable customers because you then begin to deteriorate their customer experience.

**Dilya Ibragimova**

That's very clear. Thank you very much.

**Sipho Maseko**

Thank you.

**Operator**

Thank you. Sir, we have no further questions in the queue. Do you have any closing comments?

**Sipho Maseko**

No. Thank you very much. I mean, thanks to everyone for their time and hopefully we will engage in one form or another going forward. And we continue to be pretty focused on the task at hand and we will certainly hopefully speak to you again in this form when we present our media results. Thank you.

**Operator**

Ladies and gentlemen that concludes this conference call and you may now disconnect your lines.

END OF TRANSCRIPT

