CORPORATES

MOODY'S
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CREDIT OPINION
28 March 2018

Update

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RATINGS

Telkom SA SOC Limited

Domicile	South Africa
Long Term Rating	Baa3
Type	LT Issuer Rating - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Telkom SA SOC Limited

Update of Key Credit Factors Following Conclusion of Sovereign Review

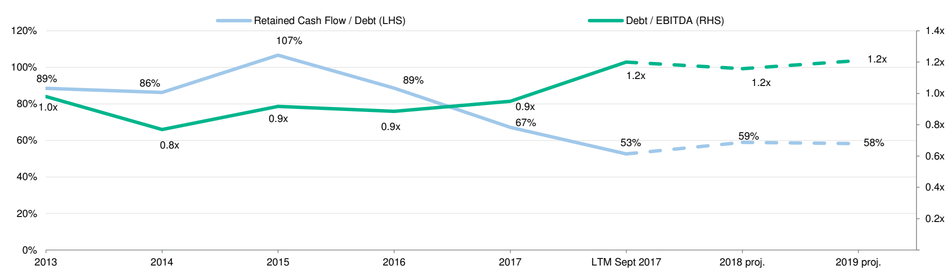
Summary

Telkom SA SOC Limited's (Telkom) Baa3/Aa1.za long-term issuer ratings reflect Moody's view on the fundamental credit quality of Telkom, represented by a Baseline Credit Assessment (BCA) of baa3, combined with the strong linkage between Telkom and the Government of South Africa as reflected by our assumptions of "high" dependence on and "moderate" support from the South African government. Telkom's ratings and outlook are in line with the government of South Africa's bond rating of Baa3 with a stable outlook.

Telkom's BCA of baa3 continues to reflect the transformation process of its business model and the execution challenges faced through (1) strategies to increase adoption of information communication technology (ICT) among its business customers; (2) customer service improvements; and (3) network upgrades for its improved bundled offerings. The current BCA is also based on Telkom's low leverage and overall strong credit metrics for the rating category. This offsets to some degree Telkom's operating and competitive challenges, as well as the larger capital investments required to deliver on its key strategies for the upcoming years. The rating further assumes that Telkom will not experience any difficulties in terms of liquidity, refinancing or funding and so will be able to meet its financial and operating commitments. To the extent these would arise, further downward pressure would be exerted on the rating or outlook. However, we recognise the company's position as a leading telecommunications operator, with a leading market position in South Africa's fixed-line business and a growing presence in broadband and mobile offerings.

Exhibit 1

Strong credit metrics and low leverage offset business risk



Source: Moody's Financial Metrics, LTM = Last twelve months

Credit strengths

- » Leading market position in South Africa's fixed-line business with the largest fibre network in South Africa based on fibre kilometres
- » Evolving business model, growing mobile business and right sizing of the cost base mitigate declining voice revenues
- » Strong credit metrics and liquidity, supported by stabilising operating performance

Credit challenges

- » Highly competitive telecommunication industry within broadband and mobile in South Africa
- » Structural decline in fixed-line voice revenues
- » Execution risk around Telkom's convergence strategies

Rating outlook

The stable outlook assumes that Telkom continues to execute on its strategies to de-risk the business from declining fixed line voice revenues and gain steady market share in its mobile offering. The stable outlook further assumes that leverage will not increase materially from current levels and liquidity will remain strong at all times.

Factors that could lead to an upgrade

As a result of the high degree of rating linkage to the South African government bond rating any future rating pressure on Telkom's ratings will have to be considered in the context of the South African long term bond rating position and outlook at the time.

Subject to the South African government bond rating, Moody's would consider an upgrade if:

- » Telkom is successful in its turnaround strategy to diversify the business away from the structural decline in voice revenues;
- » The company right sizes its cost base and demonstrates that its mobile business remains profitable such that the company's consolidated EBITDA margin is on an improving trajectory above 30% on an adjusted basis.

Factors that could lead to a downgrade

Negative pressure on Telkom's rating or outlook will be prompted by:

- » Higher-than-expected competitive threats or execution challenges in its mobile offering or bundled services that leads towards further operating margin declines;
- » EBITDA margin falls and is sustained below 20% (for last twelve month to September 2017 (LTM Sept 2017)- 27.4%);
- » Leverage, as measured by debt/EBITDA, increases towards 2.5x (for LTM Sept 2017 - 1.2x); and
- » Retained cash flow/total debt is below 25% (for LTM Sept 2017 - 52.6%) on a sustained basis as a result of higher debt levels or dividend distribution.

All metrics are according to our standard definitions and analytic adjustments.

Telkom's ratings may also be negatively affected by changes in the ratings of the government of South Africa.

Key indicators

Exhibit 2

Key Indicators

Telkom SA SOC Limited [1]

	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17	LTM (09/17)	2018-proj.	2019-proj
Revenue (ZAR Billion)	32.1	31.3	32.8	37.3	41.0	40.8	41.5	42.4
Debt / EBITDA	1.0x	0.8x	0.9x	0.9x	0.9x	1.2x	1.2x	1.2x
RCF / Debt	88.6%	86.2%	106.7%	88.6%	67.2%	52.6%	58.9%	58.2%
(EBITDA - CAPEX) / Interest Expense	3.8x	2.4x	4.6x	5.3x	2.1x	1.5x	1.6x	1.8x

[1]All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations
Source: Moody's Financial Metrics™

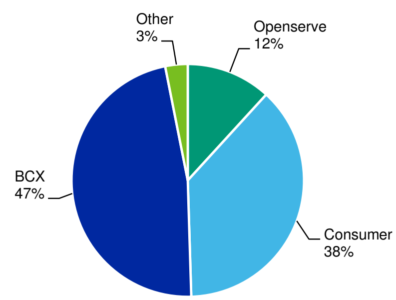
Profile

Telkom is the dominant South African fixed-line and the fourth incumbent mobile operator which controls approximately 2.8 million telephone access lines, most of which are connected to digital exchanges, and 4.4 million active mobile subscribers, representing around 5% of the South African mobile market. As of 30 September 2017, the company has the largest fibre network across South Africa (approx. 80% of the South African fibre network) supporting more than a million broadband subscribers.

Telkom is listed on the Johannesburg Stock Exchange and is 39.3% owned by the South African Government, 11.9% by Public Investment Corporation (PIC) and the remaining 48.8% is free float, as of 30 September 2017.

Exhibit 3

Telkom LTM Sept 2017 - Revenue split by business segment



Source: Company's reports

Detailed credit considerations

Leading fixed-line operator but competition intensifying

Our rating captures Telkom's dominant position as a provider of fixed-line operations, which is balanced by its small but growing mobile operations and the intense competition the company faces in all three main areas of its operations: fixed-line voice, mobile and data/internet services. Telkom has an integrated telecoms business model encompassing both fixed-line and mobile operations, such a model is more robust and de-risks revenues compared to a single platform. This is mainly because Telkom can target a wider array of customers and segments and is able to provide bundled packages where single platform operators cannot. As a strong fixed-line and broadband incumbent, and as the fourth player in the South African wireless market, Telkom has a business model of pursuing a convergence strategy that offers a competitive advantage relative to its competitors.

We note however that the South African telecoms industry is consolidating where mobile competitors are pursuing similar convergence offerings in the market which will threaten Telkom's competitive advantage. Apart from the traditional mobile operators (Vodacom, MTN and Cell C) in South Africa, Telkom also faces competition from disruptive technologies such as over the top providers and mobile virtual network operators (MVNO's).

Telkom challenges mainly centre around (1) growing its current position in broadband; (2) expanding its converged services and mobile offering profitably to offset the decline in its fixed-line business; and (3) re-orientating its fixed-line business to target a higher margin generation subscriber base.

Telkom has implemented various measures to defend its dominant position as a fixed line operator, which include (1) improving the customer experience; (2) winning back traffic through fixed-to-mobile convergence and greater competitive bundled packages and pricing tariffs; (3) leveraging next generation networks (NGN) technology to provide high-quality broadband and aggressive rollout of fibre "past" the home (2.4 million premises passed of which 300,506 are fibre to the home and 2,123,523 are fibre to the cabinet); (4) encouraging customers to move to annuity-based bundles and calling plans; and (5) diversifying its revenue streams (BCX acquisition). These measures give Telkom better visibility of future cash flows and allow for better financial planning.

Evolving business model mitigates fixed-line voice revenue decline

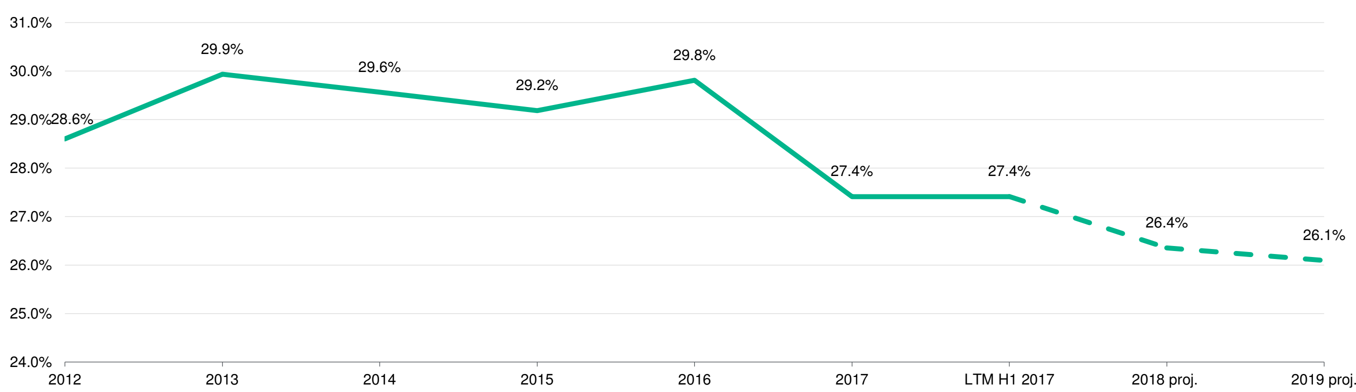
Telkom's fixed-line subscriber and usage continues its structural decline as customers migrate to mobile and broadband, which has required Telkom to take corrective measures to turnaround its business model to ensure it remains competitive and profitable. Telkom's transformational strategies focus on (1) improving profitability through cost optimisation (internal cost savings and exit of loss making operations); (2) improving customer service; (3) de-risking its mobile operations and expanding its convergence strategy and; (4) rolling out fibre optic and growing its current position in broadband.

Part of Telkom's realignment strategy aims to establish itself as the leading converged (fixed/mobile voice and data) South African communication provider through the provisioning of a range of hosting services, managed solutions, mobile voice and wireless broadband services. Further to this, the acquisition of Business Connexion (BCX) on 1 September 2015 has helped Telkom increase its ICT services, including cloud-based and data centre service, and bolster its lagging business/enterprise solutions offerings. The BCX acquisition has also strengthen and diversified Telkom's revenue base towards alternative services and become less reliant on voice revenues (as of LTM September 2017 voice revenues contributed 34% to group revenues vs 41% in FYE 2016).

Adjusted EBITDA margins have been relatively stable over the past 3 years and only declined in 2017 as a result of the inclusion of the BCX, which has a lower EBITDA margin of around 15%. We expect EBITDA margins to remain under pressure as its operations face stiffer competition and capital constraints on IT spend from its local businesses customer base.

Exhibit 4

EBITDA margin expected to remain under pressure due to constrained IT spend from businesses in South Africa



Source: Moody's Financial Metrics

The implementation of these strategies are still being rolled out and there remains a level of execution risks as far as the success of its implementation at this stage. To facilitate and drive its strategy Telkom has implemented a more flexible and agile operating model and restructured its operations into 5 distinct and independent operating divisions, namely Openserve, BCX, Telkom consumer, Trudon and Gyro. This will ensure greater accountability and better cost deployment within each division.

We expect Telkom to continue focusing on both organic growth with smaller bolt on acquisitions and appropriately-prized larger opportunities, as management focuses on enhancing its existing operations. Acquisitions will be financed largely with operating cash flow and debt where required and will only be pursued if it gives them access to an operation that has sizable market positions in its respective sector, in line with its recent acquisition of BCX.

In addition to the execution risks around Telkom's own strategic initiatives there remains uncertainties in the South African regulatory environment given it is still evolving and susceptible to changes. There are a number of critical regulatory decisions that will effect Telkom which are difficult to assess at this stage, namely (1) future spectrum allocations (access to spectrum below 1000MHz offers greater coverage with less infrastructure requirements); (2) local loop unbundling; and (3) Telkom's involvement fulfilling the government's National Broadband Plan of providing internet access more widely to the South African population.

Financial credit metrics remain strong despite operating performance pressures

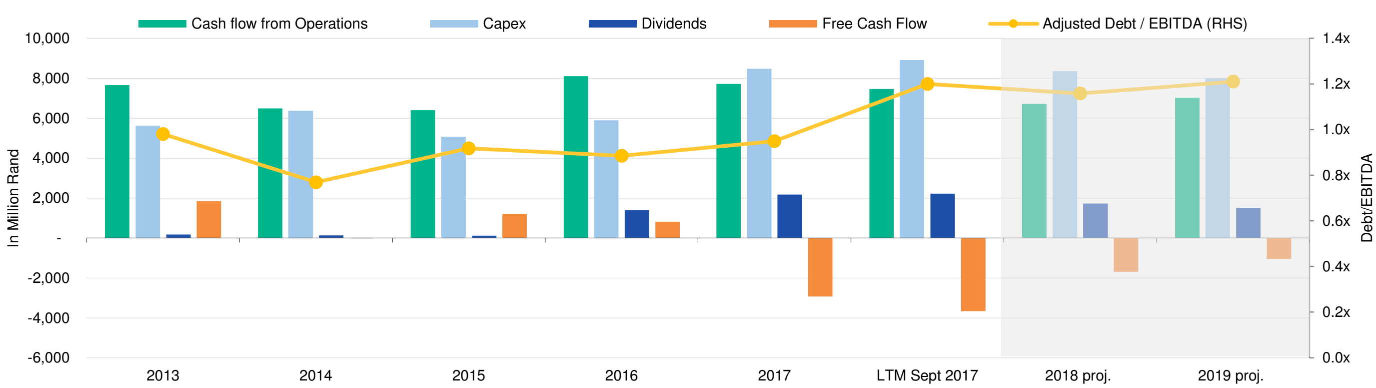
Despite declining fixed-line voice revenues, Telkom's operating results have been relatively stable due to its transformational strategies that were started in 2013. In the current weak economic environment we anticipate low single-digit organic revenue growth with pressure operating margins. Telkom's growth strategy may entail higher economic, financial or political risks and the execution risk of Telkom's transformation plan remains high and might take some time to fully materialise. However, the strong balance sheet in the form of low debt levels and leverage metrics gives Telkom the financial flexibility under the current rating to pursue its turnaround strategy. Furthermore, we expect that Telkom will remain committed to an investment-grade rating maintaining its conservative financial policies and preserving its strong financial credit profile. Management has maintained stable metrics with net debt/EBITDA of 0.7x within the board target of below 1.0x.

Telkom has increased its capex spend to a range of ZAR7 billion to ZAR8 billion or 17% to 20% of revenues with the deployment focused on the modernisation of its copper network to fibre and expansion of its mobile infrastructure (less reliant on roaming agreements in high usage areas). This compares to local competitors, MTN South Africa of ZAR11.5 billion and Vodacom South Africa of ZAR8.7 billion, capex spends.

We expect operational cash flow to remain sufficient to meet Telkom's higher capex spend however the resumption of dividend payments (policy of 60% of headline earning per share) is likely to lead marginal negative free cash but without a material impact on debt levels or leverage metrics.

Exhibit 5

Expected moderate increase in leverage due to negative free cash flow generation



All numbers are as adjusted by Moody's
Source: Moody's Financial Metrics

South African government support and dependence assumptions result in no rating uplift

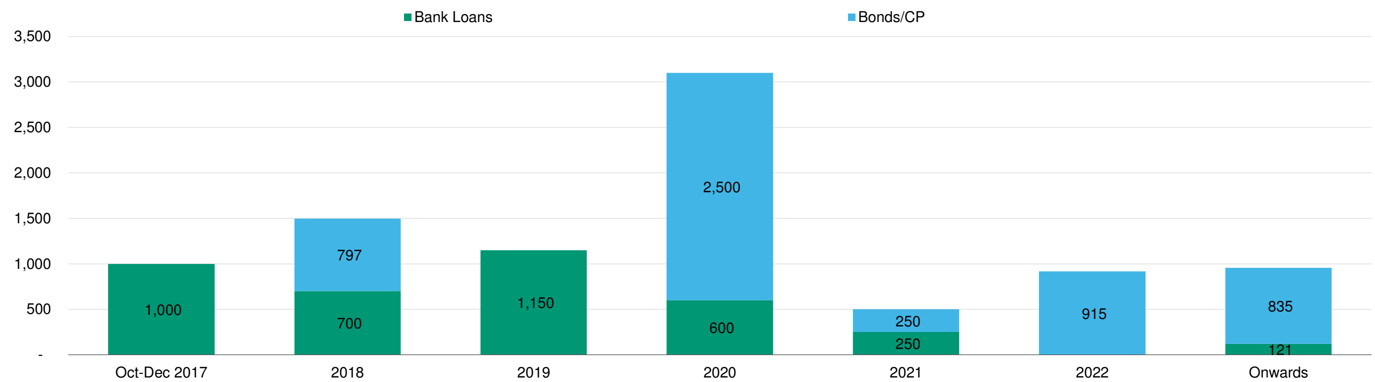
The default dependence assessment reflects the degree of correlation of a government related issuer (GRI), such as Telkom and its supporting government to being jointly susceptible to adverse circumstances that simultaneously move them closer to default. The "high" default dependence reflects our view that both the South African government and Telkom's performance are highly correlated to the general business cycle in South Africa. In addition, it factors the moderate link between the government and Telkom, given the firm's partial privatisation during the past decade and the presence of new entrants into both the fixed and cellular telecommunications market. Despite its 39.3% stake in Telkom, the South African government has no board representation which limits its influence over the strategic direction of the company.

The "moderate" support assessment reflects the strategic role of the company in expanding telecommunications links to citizens in rural areas and in poorly serviced townships adjacent to large urban centres. The assessment also takes into account the government's moderate interventionist tendencies. Any reduction in government ownership could weaken our support assumption, however will not impact the overall rating position given Telkom's strong stand alone credit profile as reflected by the baa3 BCA which is currently in line with the Government of South Africa.

Liquidity analysis

We consider Telkom's liquidity profile to be adequate as it benefits from ZAR1.4 billion cash balances as of 30 September 2017 combined with liquid marketable securities of ZAR2.5 billion and expected positive operating cash flows of around ZAR8.5 billion per year. This is sufficient to meet its committed obligations over the next 12 months, which includes debt maturities of ZAR2.3 billion, sizeable planned capex of between 17% and 20% of net operating revenues, and a dividend payment to shareholders.

Exhibit 6
Telkom's debt maturity profile



Source: Company reports (September 2017)

In addition, Telkom has access to a ZAR4 billion committed borrowing facility of which ZAR3.2 billion was undrawn as of 30 September 2017. The facility is subject to two financial covenants, interest cover and net leverage, which the company has been able to meet comfortably.

Rating methodology and scorecard factors

Our Rating Methodology for the Telecommunications Service Providers Industry, published in January 2017, sets out how Moody's analyses the credit risk of telecommunications companies and arrives at their ratings. The methodology examines the core factors that Moody's considers most relevant to telecoms operators, sets out the range of possible outcomes by factor, and maps these outcomes to a rating range. Each factor is appropriately weighted and, in combination, contributes to the rating output by the methodology grid.

Exhibit 7

Rating Factors				
Telkom SA SOC Limited				
Telecommunications Service Providers Industry Grid [1][2]	Current LTM 9/30/2017		Moody's 12-18 Month Forward View As of 12/13/2017 [3]	
Factor 1 : Scale (12.5%)	**Measure**	**Score**	**Measure**	**Score**
a) Revenue (USD Billion)	$3.1	B	$3.1	B
Factor 2 : Business Profile (27.5%)				
a) Business Model, Competitive Environment and Technical Positioning	B	B	B	B
b) Regulatory Environment	Baa	Baa	Baa	Baa
c) Market Share	Baa	Baa	Baa	Baa
Factor 3 : Profitability and Efficiency (10%)				
a) Revenue Trend and Margin Sustainability	Baa	Baa	Baa	Baa
Factor 4 : Leverage and Coverage (35%)				
a) Debt / EBITDA	1.2x	A	1.1x - 1.3x	A
b) RCF / Debt	52.6%	Aa	57% - 59%	Aa
c) (EBITDA - CAPEX) / Interest Expense	1.5x	B	1.5x - 1.8x	B
Factor 5 : Financial Policy (15%)				
a) Financial Policy	Baa	Baa	Baa	Baa
Rating:				
a) Indicated Outcome from Scorecard		Baa3		Baa3
b) Actual Rating Assigned				Baa3
Government-Related Issuer	**Factor**			
a) Baseline Credit Assessment	baa3			
b) Government Local Currency Rating	Baa3			
c) Default Dependence	High			
d) Support	Moderate			
e) Final Rating Outcome	Baa3			

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] As of 9/30/2017(L)
[3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.
Source: Moody's Financial Metrics™

Appendix

Exhibit 8
Peer Comparison Table

	Telkom SA SOC Limited			MTN Group Limited			Telefonica Brasil S.A.		
	Baa3 Stable			Ba1 Stable			Ba1 Negative		
(in US millions)	FYE Mar-16	FYE Mar-17	LTM Sep-17	FYE Dec-15	FYE Dec-16	LTM Jun-17	FYE Dec-15	FYE Dec-16	LTM Sep-17
Revenues	$2,740	$2,921	$3,054	$11,592	$10,093	$9,800	$12,289	$12,254	$13,436
EBITDA	$817	$801	$836	$5,852	$4,370	$4,096	$4,714	$5,070	$5,638
Total Debt	$670	$795	$972	$8,326	$13,718	$14,156	$5,948	$7,032	$6,856
Cash & Cash Equivalents	$173	$120	$102	$2,206	$2,002	$1,782	$1,349	$1,569	$1,761
EBITDA Margin	29.8%	27.4%	27.4%	50.5%	43.3%	41.8%	38.4%	41.4%	42.0%
(EBITDA-CAPEX) / Interest Expense	5.3x	2.1x	1.5x	3.7x	1.6x	1.1x	3.4x	3.6x	4.0x
Debt / EBITDA	0.9x	0.9x	1.2x	1.7x	2.9x	3.3x	1.5x	1.3x	1.2x
FCF / Debt	8.2%	-27.5%	-27.9%	-14.7%	-7.7%	-0.2%	-2.4%	4.4%	7.6%
RCF / Debt	88.6%	67.2%	52.6%	20.7%	5.4%	8.4%	52.6%	63.9%	71.0%

Note: Telefonica Brasil S.A. Ba1 rating is constrained by the Government of Brazil (Ba2 negative)
Source: Moody's Investors Service

Exhibit 9
Telkom - Moody's adjusted Debt breakdown

(in ZAR Millions)	FYE Mar-13	FYE Mar-14	FYE Mar-15	FYE Mar-16	FYE Mar-17	LTM Ending Sep-17
As Reported Debt	**720.9**	**389.5**	**400.9**	**358.6**	**475.7**	**654.6**
Pensions	-	-	67.0	86.6	85.8	85.2
Operating Leases	300.4	287.2	256.3	224.4	233.8	232.2
Moody's-Adjusted Debt	**1,021.2**	**676.8**	**724.2**	**669.6**	**795.3**	**972.0**

All figures are calculated using Moody's estimates and standard adjustments
Source: Moody's Investors Service

Exhibit 10
Telkom - Moody's adjusted EBITDA breakdown

(in ZAR Millions)	FYE Mar-13	FYE Mar-14	FYE Mar-15	FYE Mar-16	FYE Mar-17	LTM Ending Sep-17
As Reported EBITDA	**912.7**	**1,038.9**	**835.2**	**657.2**	**771.8**	**803.5**
Pensions	- 0.5	- 0.5	- 73.3	- 46.0	- 30.7	- 32.2
Operating Leases	109.0	99.9	93.7	80.8	74.5	78.1
Unusual	112.8	- 220.5	10.2	124.9	- 14.8	- 13.5
Non-Standard Adjustments	- 0.2	- 0.3	-	-	-	-
Moody's-Adjusted EBITDA	**1,133.7**	**917.5**	**865.8**	**816.9**	**800.8**	**836.0**

All figures are calculated using Moody's estimates and standard adjustments
Source: Moody's Investors Service

Ratings

Exhibit 11

Category	Moody's Rating
TELKOM SA SOC LIMITED	
Outlook	Stable
Issuer Rating	Baa3
NSR LT Issuer Rating	Aa1.za

Source: Moody's Investors Service

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