

# Conference call transcript

7 February 2022

## Q3 TRADING UPDATE

### Operator

Good day ladies and gentlemen and welcome to the Telkom SA Ltd Q3 trading update. All participants will be in listen only mode. There will be an opportunity to ask questions later during the conference. If you should need assistance during the call, please signal for an operator by pressing \* then 0. Please note that this call is being recorded. I would now like to turn the conference over to Serame Taukobong. Please go ahead, sir.

### Serame Taukobong

Thank you very much. I think it's going to be quite a challenging surname to remember. Good afternoon everyone and good morning to our colleagues in the US. With me I have our group CFO, Dirk Reyneke, and our Head of Investment, Babalwa George. I'd like to unpack today in three steps. I will talk about the trends that we've experienced in the third quarter of the year. Dirk will then go deeper into the financials. I will then come back and conclude with the value unlock programme as well as an update on the various regulatory issues that we're seeing.

So top line I can say that I'm pleased with the performance that we've seen, especially in the broadband market despite a very intensive competitive landscape. Just to highlight some of the key operational messages demonstrated in this market, what we saw in the last quarter was certainly a double digit growth in active base, especially with post-paid. We had indicated to the market that we'd be doing quite a lot of post-paid recovery plans. We've seen that come through. Mobile broadband continues to support our growth. Fibre is heading in the trajectory that we seek, especially under the [unclear] end review. And the tower build programme remains on track. I think as to date we've now connected over 7,000 towers on mobile.

Although our group revenue was under pressure in the period under review, it negatively impacted our underlying group EBITDA performance. However, we feel that the cost management programmes that we've put in place continue to deliver efficiencies with opex declining year on year exceeding certainly even our expectations and maintaining and containing that opex growth below inflation. Group EBITDA is up 5.4% to R2.8 billion with EBITDA margin expansion of 1.9% to 26.7% at group level. On a normalised basis our group EBITDA declined 1.4%. And I think despite the aggressive cost challenges we did not see the impact and offset the decline of the 2.3% decline in group revenue.

Looking at the business trends I'll start with consumer. In the consumer business relatively stable revenue to the quarters reported at R6.544 billion driven by the mobile business which grew 4.9% in revenue. Mobile growth, as I indicated earlier, is driven by double digit growth in active base despite the competitive market. Our post-paid base grew to 2.6 million. I think we had been in previous months showing a decline in post-paid, and I'm happy to report that we're now seeing a

reverse of this. So the December activities have done quite well in that regard. And the ARPU remains steady at R215. The prepaid market continues to be a big driver for us with the base growing by 12% to 13.8 million. The ARPU at R67 is pretty much in line with the guidance that we gave that between R67 and R70 is pretty much where we remain focussed.

From a broadband perspective we really saw a 7.9% increase in data traffic to 246 petabytes, which then resulted in a 4% growth in mobile broadband subscribers to 10.5 million and data revenue growth of 2.6% year on year at R3.127 billion. Overall it then resulted in mobile service revenue – that is now the revenue excluding handsets – at about 2.3% year on year to R4.5 billion in a relatively competitive environment. That is the points on mobile and consumer.

Let me touch on BCX. BCX revenue declined by 3.6% to R3.7 billion for the quarter, really impacted seriously by the chip shortage which we are seeing globally which has really impacted BCX negatively. I think the key driver for that IT business going down 8.8% year on year is really from the backlog of this IT hardware and chip shortage. I think as we communicated to the market before, we really are seeing most probably the strongest order book for BCX, but unfortunately the global shortage is affecting us quite significantly. The converged communication, i.e. the fixed business, the revenue grew 2.9% compared to the prior year. I think with the resurgence of people going back to work we hopefully will see this trends proceeding for us.

As far as Openserve is concerned I think the Openserve revenue stabilisation for the past year is really driven by a couple of key things. We've seen the revenue of R3.3 billion in line with the quarters that we reported, marginally lower than the previous quarter as an impact of the seasonality that we see typically in the last financial quarter arising from small and medium business. In terms of the connectivity and the big focus for Openserve is really about the fibre to the home footprint, which is really our big focus in driving not just homes passed but also homes connected equally. Openserve grew homes passed with fibre by 65.5% compared to last year. We are now just over 800,000 homes passed. Equally we've increased the number of homes connected by 38.6%, now up to 358,000 plus homes connected. This represents a connectivity rate of about 44.8%. It's slightly lower than what we presented earlier, certainly in the past period, but the big focus is really driving our capex spend to ensure that we balance quite significantly homes passed and homes connected. More importantly, we've seen growth in the fixed traffic which has grown by 23% to 428 petabytes. And this is really supported strongly by the fact that over 75% of our customers now sit on minimum speed of 10 mbps, so a big focus on ensuring that we drive quality of the home connections.

In terms of our mast and towers, Swiftnet continues with its steady revenue growth, increasing its revenue by 4.6% to R317 million supported by the addition of 159 new external leases for the quarter. The tower build programme remains on track with 56 towers constructed in the quarter under review amounting to 114 towers constructed in the financial year. We continue to advance the development programmes with various property investors for select property development opportunities which are in the investment stage and pre-construction phase. I will now hand over to Dirk to unpack the details of the financial messages and I will revert after Dirk.

#### **Dirk Reyneke**

Thank you, Serame, and good afternoon to colleagues. Good morning to the US colleagues. As usual I will deal with revenue, cost, EBITDA and capex each in its own category. Serame has alluded to the tough trading environment out there. The group revenue is under pressure in the period under review. We saw our group revenue declining by 2.3% year on year to R10.7 billion. We saw revenue growth in our mobile and mast and tower businesses grew 4.9% and 4.6% respectively in the quarter under review compared to Q3 of the prior year.

Total data revenue, mobile and fixed, was flat in comparison with the same quarter of the prior financial year. This growth in revenue was mainly offset by the IT business challenges. Serame has referred to the global shortage in chip shortages which led to BCX unable to fill back orders for IT hardware in the first nine months of the financial year. And in addition, our legacy fixed business continues to decline, although the rate of decline has slowed down from double digit decline we saw in the prior year to 7.1% in the current year.

If we look at our cost management, our sustainable cost management continued to deliver efficiencies despite challenges in the revenue. Our cost management programme continues to deliver positive results with total expenses reducing 4.8% compared to Q3 of the prior year. The opex reduced by 7.5% year on year, which far exceeds management targets of containing opex growth below inflation. I think our mobile cost to serve ratio reduced from 30.9% in the prior year of the same period to 26.9% in the current period as we further optimised roaming cost as a percentage of revenue despite the growth in traffic. I need to say that that is even before we see the upside benefit of the second roaming agreement as that has only gone live towards the end of the prior year and there will only be a small contribution in the current year, but mostly in Q4. The benefits of the roaming agreement are therefore still to be realised, and those benefits will only be flowing in as from Q4 of the current financial year.

Our underlying group EBITDA was impacted by the reduction in revenue. On a normalised basis, in other words if you exclude the impact of the VSPs in the prior year, the group EBITDA declined 1.4% as the cost savings were not sufficient to offset the decline of 2.3% in group revenue. On a statutory basis however the group EBITDA is up 5.4% to R2.9 billion with an EBITDA margin expansion of 1.9% to 26.7%.

Lastly in terms of our capital approach of disciplined capital investment while focussing on the key growth areas, capex was down by 29.2% to R1.5 billion and continues to focus on the growth areas such as the mobile business and fibre. You will recall acceleration in Q3 of the prior year. I think that's why on a year on year basis a slight decline. Mobile capex investment of R2 billion for the financial year to date in Telkom consumer enabled improved capacity and coverage with more than 7,000 base stations now integrated, representing a 15.4% year on year increase in base stations.

The ongoing investment enabled Openserve to carry the increased demand in data services through upgrading the high capacity sites and expanding the fibre footprint. And then lastly, the tower build programme remains on track. I think Serame has covered 56 towers constructed in the quarter amounting to 114 towers constructed in the financial year. Management will remain disciplined in capital allocation while investing in the business for growth. Serame, that concludes the financial numbers. I will now hand back to you to conclude the conversation. Thanks.

### **Serame Taukobong**

Thank you kindly, Dirk. So in closing I'll just cover three topics. Management remains on course certainly with our value unlock to our shareholders. The board remains committed to pursuing the listing of Swiftnet, i.e. our mast and towers business, on the JSE before our financial year end. Substantial progress has been made in this regard and we certainly hope to make an announcement in the next two weeks in that regard. We believe that this will significantly contribute to the sentiment that we've expressed in our value unlock.

Two issues, let me just give an update on the regulatory environment. I think from the onset I must state that Telkom does support the release of spectrum. It should be, however, released following a lawful and reasonable process. The release of spectrum must promote effective competition for the benefits of the consumer, the sector and the business. As such, Telkom has requested an expedited review of the current flawed process. Subject to deliberations of the court, Telkom has requested that the review be held from the 1<sup>st</sup> to the 4<sup>th</sup> March in that period. We are hoping or have received confirmation that case management will be held on 8<sup>th</sup> February, which is tomorrow, and we'll be in a position to comment on how this thing moves forward.

Equally, ICASA has published a discussion document on the review of the call termination regime. Public hearings started today. We have expressed concerns that the proposed removal of the pro-competitive mobile termination rates, i.e. the MTR, asymmetry for operators with the market share of less than 20%, combined with the retention of the fixed termination rate differential will hinder smaller operators' ability to compete effectively. We will be able to update the gathering once those hearings are complete.

The last but not least point is a comment on the SIY investigation. I think the matters in the SIY investigation are of public knowledge. Based on the information currently at the company's disposal, Telkom does not anticipate that the investigation

by the SIY will reveal any new facts and any losses. At this point Telkom expects no [break in audio] from this. We will wait for further clarity. We've already been assigned an investigator by the SIY and Telkom continues to ensure that we cooperate with the SIY fully. So with that I will then hand over to Madame Operator for questions and answers. Thank you.

**Operator**

Thank you very much, sir. If you would like to ask a question, please press \* then 1 on your touchtone phone or on the keypad on your screen. If you decide to withdraw the question, please press \* then 2 to remove yourself from the list. Again, if you would like to ask a question, please press \* then 1. The first question comes from Jonathan Kennedy-Good from JP Morgan. Please go ahead, Jonathan.

**Jonathan Kennedy-Good**

Good afternoon. Just two questions from me please. In terms of your mobile broadband customers those came off marginally quarter on quarter it seems to just under 10.5 million. I'm just wondering, is there particular competitive intensity that has worsened during the period from competitor offerings in that space and how you see that evolving over the next six months. And then also if you could remind us of what your free cash flow targets were for the full year and whether the update has any impact on that.

**Serame Taukobong**

Thank you, Jonathan. I'm not sure, Madame Operator, do you take question by question or take a few?

**Operator**

We can take Jonathan's question. You can address all his questions and then we can move on to the next person, sir.

**Serame Taukobong**

Thank you so much. On the mobile broadband I think it's really a function of seasonality. We remain quite confident in terms of the pricing propositions that we have in the market, Jonathan. Equally we are launching quite aggressive attack plans on fibre to complement the mobile broadband strategy. On the free cash flow I'll hand over to Dirk to share some colour on that.

**Dirk Reyneke**

Jonathan, thanks for the question. I think clearly the revenue decline impacted by a decline in legacy and BCX continues to have a serious impact on our free cash flow. The turnaround is slower than anticipated when I spoke to you three months ago and definitely six months ago. But we are expecting our free cash flow performance to improve half on half. Certainly we will be doing significantly better than H1. And our aspiration, Jonathan, if you want to compare to previous targets, I think our aspiration currently is to return to positive free cash flow. And I'll leave it there. Thanks.

**Jonathan Kennedy-Good**

Great. Thank you.

**Operator**

Jonathan, do you have any further questions?

**Jonathan Kennedy-Good**

No, that's it from me. Thank you.

**Operator**

Thank you very much. Ladies and gentlemen, just another reminder, if you would like to ask a question, please press \* then 1. If you would like to ask a question, please press \* then 1. The next question comes from Nadim Mohamed from SBG Securities. Please go ahead, Nadim.

**Nadim Mohamed**

Good afternoon everybody. Two questions from my side. We saw an acceleration in fixed voice and subscription declines of about 20% year on year. I would like to get a sense from you as to what happened there. What was driving the acceleration? I know it has been declining for quite some time, but I would like to understand why it was accelerating. Then just on fixed data, could you give some sense on the trends that you're seeing in the market? You've got your fibre businesses that are growing relatively fast, but you've got declines in some of the other areas. I would like to understand the declines we've seen in this quarter. Was it driven by pricing, by volume, by competitive intensity? Just to get a sense of what's going on there. Thank you.

**Serame Taukobong**

Thank you Nadim. The fixed voice decline I think is pretty much aligned with the seasonality that we see in December with corporates going on leave. What we are doing to really aggressively curb that is for instance on our S&D [?] proposition we have launched, for instance, prepaid fibre. We will be including in our fibre packages things like Teams as part of that. So fixed voice in this quarter, for example, shows that voice is not declining. It has just moved to better platforms. So what we are comfortable with for the first time is that what we're seeing on fixed voice revenue is coming through on our next generation platforms as opposed to our traditional copper. So it is the aggressive evolution that we will be driving in the next few quarters to make sure that we migrate as many of our copper subscribers into fibre, including voice in those packages, which is something that Telkom can do. I hope I've covered you, Nadim.

**Nadim Mohamed**

Yes. Thank you. Then just the question on fixed data. I just wanted to get a sense on what's driving the dynamic there. Is it around volumes or are you seeing any particular competitor come in really hard in this space?

**Serame Taukobong**

No, not really. I think as we've said in fixed data, obviously there is quite a bit of market activity with fibre operators in the market. But what we've also said quite strongly, and the focus for me certainly coming from my past in the mobile environment, is how we execute with speed and aggressively drive that copper to fixed migration with fibre to make sure that at the bare minimum we protect that traditional volume on data. So I'm hoping that when we next speak to you in June we will be showing far more aggressive numbers and growth in that regard.

**Nadim Mohamed**

Thank you so much.

**Dirk Reyneke**

Perhaps just to add on your first question on fixed voice and subscriptions coming down, I think if you look at it on a percentage basis yes, it's coming down because it's from a lower base. If you look at it on an absolute basis I think Q3 2020 to Q3 2021 it was close to R450 million reduction. We are currently at R300 million reduction. So in absolute numbers because the base is smaller the reduction is smaller but the percentage will increase because it's coming from a much lower base.

**Nadim Mohamed**

Got it. Thank you so much. Appreciate that.

**Operator**

Thank you. Ladies and gentlemen, just one final call, if you would like to ask a question please press \* then 1. If you would like to ask a question, please press \* then 1. We will pause to see if there are any further questions. The next question comes from Vikhyat Sharma from RMB Morgan Stanley. Please go ahead, Vikhyat.

**Vikhyat Sharma**

Hi guys. Thanks for the opportunity. My question is more around the mobile service growth recovery. I think clearly there might be a big base of COVID that you might be lapping etc. But the whole idea seems like the growth there hasn't been living up to the expectations because three months ago you indicated that second half growth would pick up. That doesn't seem to have been the case. Is pricing going to come into play or have the other competitors been more competitive there just in terms of competitive landscape? And Telkom's own positioning on the price side now, I know you haven't reaped the benefit of this new roaming agreement, so once you reap the benefit is it basically that you're going to take the pricing down again to create more subscriptions or more additions into that prepaid base, or are you happy with your pricing? I'll leave it there.

**Serame Taukobong**

Thank you. I'll take that one. I think the market itself if you look at the reports from our competitors the growth on revenue certainly is sitting in the lower single digits. To your point on pricing, we're very comfortable with the pricing position that we have. What we have done, which might not seem material in the price drops, we've had a challenge obviously being reliant so much on roaming of differentiating our pricing for an on-net and off-net. So what we've done to adjust our pricing is offering more on-net propositions, which means that we take into account the impact of roaming. But it means that customers when they buy a package they can buy a package that talks to an all-net type of proposition. Absolutely right that when we do kick in with the second roaming partner, as Dirk highlighted, we hope to see the impact of that in the new financial year. The technical roaming execution has happened now. That will also have a significant impact for us in our go to market approach where we can go now for a more all-net type proposition which makes us more competitive in the market.

Where we've seen aggressive pricing certainly in the mobile element has been in the high [break in audio]. We have responded quite aggressively as well with that, particularly in the 20 GB to 40 GB proposition, which is translating in the numbers we're seeing on our post-paid. In the lower packages, particularly your weekend, weekly and daily bundles, we remain very competitive in that space and we're quite comfortable with our positioning there. I hope I've covered your questions there, Vikhyat.

**Vikhyat Sharma**

Sure. Thank you.

**Serame Taukobong**

Thank you.

**Operator**

Vikhyat, do you have any further questions?

**Vikhyat Sharma**

No, thanks.

**Operator**

Thank you. The next question comes from Nicole Agar from Truffle Asset Management. Please go ahead, Nicole.

**Nicole Agar**

Thank you. Good afternoon everyone. Two questions from my side please. Firstly, the impression after listening to your interim results was that you expected mobile revenue growth forth second half of this year to at least meet or exceed your 6% revenue growth for the first half of the year. Is that a forecast that you are still comfortable with? Comfortable is a word you've used quite a lot in this call, so I'm just checking if that is still in your sights. And then the second question I have is at interims you spoke of perhaps entering into some strategic partnerships especially on the IT capability side because there was a sense that not only was there a chip problem but there was also perhaps a capability bump-up needed with an international alliance. Can you give us an update on that? Thank you.

**Serame Taukobong**

Thank you, Nicole. As English is not my tribe I'll be general with the words that I use like "comfortable". I think we remain comfortable in driving a range of a low to high single digit growth for mobile. The mobile team has recently secured two very lucrative contracts with two of the biggest churches in South Africa. Obviously we won't see that materialise in the next two months, but certainly we hope to see that materialising in the new year because those are quite significant partnerships. In regards to IT we definitely do continue to look and seek for international partners.

Further to the point in terms of capacity and scale, I'm happy to report that BCX has, for example, engaged with three significant companies which I cannot mention their names right now. But they went in there to sort out the data and issues. So three companies had significant data breaks. And as a result of BCX's intervention in two of the entities they've actually walked out not just with an intervention on the cyber-attacks but actually walked out with even a bigger contract than that. So our biggest issue in that regard is cyber-attacks are a very dominant element driving in the country. Even though BCX is a leader in that regard, we will certainly look to an international partner to help us bring with capacity and scale in that regard. We are hoping that by the time we do the next update BCX will be further down the line with securing that international partner. Nicole, I hope I've covered your questions.

**Nicole Agar**

You did. Thank you very much.

**Serame Taukobong**

Thank you so much.

**Operator**

The next question comes from Wessel Joubert from Oystercatcher Investments. Please go ahead, Wessel.

**Wessel Joubert**

Hi guys. Thanks very much for the opportunity. I just have one question on the mobile side. I suppose the revenue came in below your expectations. Can you maybe discuss if the miss was driven on the subscriber side or on the ARPU side and the reasons for that miss? It would be appreciated.

**Serame Taukobong**

Thank you, Wessel. I think what we have seen, interestingly enough, is a movement in the recharges on the mobile side partly as a result of the activities which the team launched which gave quite lucrative offerings in the off-peak type propositions. And obviously I think with seasonality and people being at home, and you have very aggressive late night data offerings, that's where we saw a growth in that revenue, obviously at a lower base. I think the key thing was everybody going back to school and us all being at level 1. We hope to see that reconnection of more peak data usage on the mobile side. It's not really due to subscription but just the shape of the consumption that we saw in the usage. Wessel, I hope I've covered your question.

**Wessel Joubert**

You have. Thank you very much. Sorry, just a follow-up if I may. I suppose it was a bit of a misstep offering, these packages, as you moved consumers from a higher ARPU to a slightly lower ARPU product. Is it fair to say if you don't offer these packages again that you expect the ARPUs to go back to normal or to a higher level?

**Serame Taukobong**

I think, Wessel, in terms of the ARPU we've seen on post-paid we're holding steady at R215. Prepaid is equally holding steady at R67. I think when we move to the more peak type propositions – and of course as the country opens up – we certainly anticipate that we will see those ARPUs holding steady if not increasing.

**Wessel Joubert**

Okay. Thank you very much.

**Serame Taukobong**

Thank you.

**Operator**

Thank you. At this point in time it seems like there are no further questions. I would just like to remind everyone for one final time, if you would like to ask a question, please press \* then 1. If you would like to ask a question, please press \* then 1. We will pause to see if there are any further questions. We have a follow-up question from Johnathan Kennedy-Good from JP Morgan. Please go ahead, Jonathan.

**Jonathan Kennedy-Good**

Thank you. Just one more on the dividend policy. Can you give us a refresher on what you expect may be your policy going forward and when we will hear exactly what to expect?

**Dirk Reyneke**

Jonathan, that's a key question. But I think I will stay to my story that we've committed that we should be communicating at least a dividend policy when we announce year-end results. Certainly the expectation is still that it will be a dividend policy closer aligned to cash flow than to earnings to make sure that you don't have to fund it through debt. But it's early days. As I say, we've had certain proposals at ExCo. We've had certain conversations at board level. But there is no finality around dividend policy. We are still committed to talk to the market again when we announce our year-end results, Jonathan.

**Jonathan Kennedy-Good**

Okay, great. Thank you.

**Operator**

Thank you. The next question is another follow-up question from Nadim Mohamed from SBG Securities. Please go ahead, Nadim.

**Nadim Mohamed**

Hi again. Just two questions from my side. Just on your capex guidance, I remember at the last call I think you're guiding to the lower R7 billion. Seeing that your run rate is about R5.2 billion if my numbers are correct, are you still holding to that guidance for the year? Secondly on your value unlock programme, I would just be curious where you're at in terms of Openserve. How far are you in terms of structurally separating it from the rest of the business? Is there anything you can share in terms of the value unlock programme there? Thank you.

**Serame Taukobong**

Perfect. I'll let Dirk take the first one. Then I can come back on the second one.

**Dirk Reyneke**

I think on capex, Nadim, we are still sticking to what we said before. The low R7 billion is certainly not the level we had last year. It will be reduced from last year, but it will be roughly in the 16% to 20% ratio that we've always stuck to. But R7 billion to R7.5 billion, low R7 billion, we are still on the route to get to that level. Thanks.

**Serame Taukobong**

Thanks. I think, Nadim, on the Openserve journey we are to by 1<sup>st</sup> April be able to do that balance sheet internal separation. But more importantly, what we are driving is making sure that we continue to drive and create value internally. So a big focus on Openserve to ensure that our external revenue becomes far more significant and the homes connected is a big ratio. We have a massive forecast that Dirk and I have sent the team. And in June we will report far significant numbers in



terms of homes connected, ensuring that we increase the focus on external revenue for Openserve. I hope that covers your question, Nadim.

**Nadim Mohamed**

Excellent. Thank you so much. I'm not sure whether you were here, but I remember previous discussions around looking at various options for Openserve including a potential listing. Is that still underway, or does that come later on in the year or next year even?

**Serame Tau**

That's far [unclear]. Right now it's just to get the accounting difficulty for Dirk out the way.

**Nadim Mohamed**

Excellent. Thank you so much.

**Serame Taukobong**

Thank you, Nadim.

**Operator**

Thank you. Serame, we have no further questions in the queue. Can I hand back to you for closing remarks?

**Serame Taukobong**

Thank you. Thank you all for joining us in this call. We hope we've covered all your questions. Our focus remains on driving the value unlock journey and ensuring that the mobile proposition continues to be competitive in the market. And with the spectrum debate currently in the market, I think it must be clearly stated that Telkom's initial and fundamental purpose is not to delay the issuing of the spectrum but to make sure that spectrum is issued in an equitable and fair manner. And with that I will close. Dirk, I'm not sure if you want to say something.

**Dirk Reyneke**

I've got nothing to add. Thanks Serame. Thanks everybody for joining. Thanks for your time.

**Serame Taukobong**

Thank you so much. Madame Operator, back to you.

**Operator**

Thank you very much, sir. Ladies and gentlemen, that concludes today's conference. Thank you for joining us. You may now disconnect your lines.

END OF TRANSCRIPT