CORPORATES

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CREDIT OPINION
12 April 2022

Update

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RATINGS

Telkom SA SOC Limited

Domicile	Pretoria, South Africa
Long Term Rating	Ba2
Type	LT Corporate Family Ratings
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

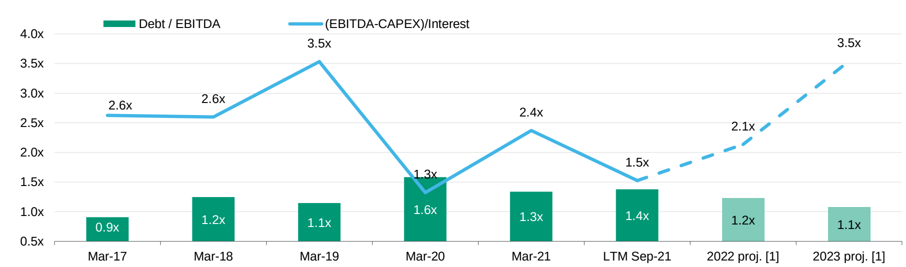
Update following affirmation of Ba2 rating and change of outlook to stable

Summary

On 6 April we affirmed Telkom SA SOC Limited's (Telkom) Ba2 corporate family rating, its Aa1.za national scale rating (NSR) and its baseline credit assessment (BCA) of ba2, the outlook was changed to stable from negative. The rating action directly follows the affirmation of the sovereign rating of South Africa at Ba2 and change of the outlook to stable from negative on 1 April and reflects Telkom's 100% operational concentration in South Africa. Telkom's ratings reflect our view of the fundamental credit quality of Telkom, represented by the BCA of ba2, combined with our assumptions of high default dependence with- and moderate support from the South African government. We classify Telkom as a government related issuer (GRI) because it is 40.5% owned by the Government of South Africa. Despite having strong credit metrics and adequate liquidity, Telkom derives all of its revenue from South Africa and therefore its credit standing is strongly correlated to the economic and regulatory environment in the country. The low growth environment and intense competition between mobile network operators will be a growth constraint to Telkom.

Telkom's BCA of ba2 is supported by (1) the company's leading market position in South Africa's fixed-line business, with a growing presence in broadband and mobile and (2) conservative financial policy and good credit metrics with debt to EBITDA of 1.4x as of the twelve months ending September 2021 (September 2021 LTM). The rating is constrained by (1) operational concentration in South Africa and exposure to the country's economic, social, political, legal and regulatory environment; (2) the company's position as the third largest operator in a highly competitive South African mobile market; and (3) low growth prospects with continued, albeit slowing decline of fixed line business and mature mobile market.

Exhibit 1
We expect Telkom's credit metrics to remain strong



[1]This represents Moody's forward view, not the view of the issuer; and unless noted in the text, does not incorporate significant acquisition and divestitures
Source: Moody's Investors Service

Credit strengths

» Successfully completed transition towards integrated telecommunications business model to mitigate declining fixed voice revenue

» Leading market position in South Africa's fixed-line business, with the largest fibre network in South Africa based on fibre kilometres

» Strong credit metrics and liquidity

Credit challenges

» Geographic concentration in South Africa

» Continued, albeit slower decline of fixed line business

» Relatively small mobile operator in highly competitive South African mobile market, with lower growth prospects going forward

Rating outlook

The stable outlook reflects the stable outlook on the sovereign bond rating of the government of South Africa, which constrains Telkom's rating. The stable outlook also reflects Telkom's good track record in adhering to its conservative financial policies and our expectation that Telkom will be able to maintain its good credit metrics and adequate liquidity despite low growth prospects.

Factors that could lead to an upgrade

Telkom’s ratings are constrained by the government bond rating of South Africa, therefore an upgrade will only be considered if the sovereign ratings of South Africa are upgraded. Following an upgrade of the sovereign ratings of South Africa, we would consider upgrading Telkom’s ratings if liquidity remains adequate and Moody’s adjusted debt/ EBITDA sustainably remains below 2.0x and EBITDA is on a stable to slowly growing trajectory.

Factors that could lead to a downgrade

Telkom's ratings are likely to be downgraded in case of a downgrade of South Africa's sovereign ratings, although Moody’s will continue to monitor resilience of Telkom’s credit profile against macro-economic shocks. A downgrade would also be considered if Telkom’s liquidity profile weakens, debt/EBITDA exceeds 3.0x on a sustained basis or retained cash flow/total debt falls below 20% on a sustained basis.

Key indicators

Exhibit 2

Key Indicators for Telkom SA SOC Limited[1][2][3]

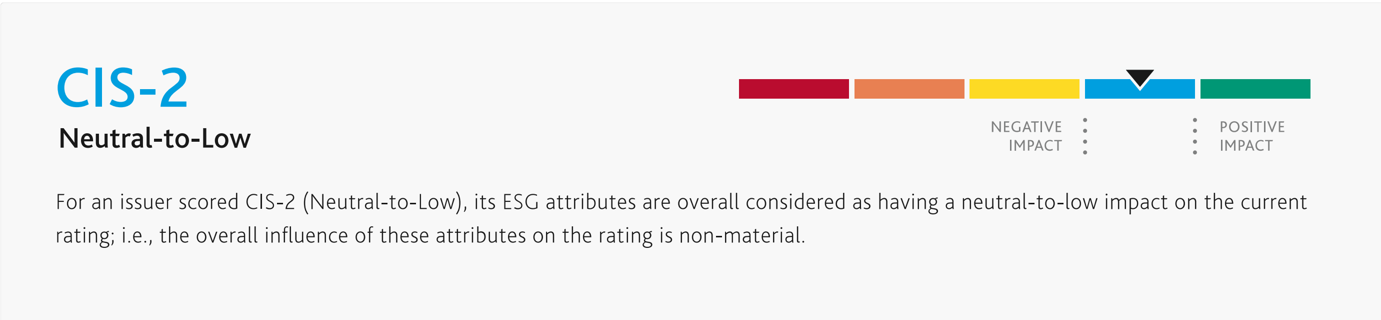
	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	LTM Sep-21	2022-proj. [2]	2023-proj. [2]
Revenue (ZAR Billion)	41.0	39.7	41.8	43.0	43.2	43.1	43.3	43.4
Debt / EBITDA	0.9x	1.2x	1.1x	1.6x	1.3x	1.4x	1.2x	1.1x
RCF / Debt	64.3%	49.3%	50.9%	39.6%	60.5%	64.8%	66.8%	71.9%
(EBITDA - CAPEX) / Interest Expense	2.6x	2.6x	3.5x	1.3x	2.4x	1.5x	2.1x	3.5x

[1] All figures and ratios are calculated using Moody's estimates and standard adjustments.
[2]Periods are Financial Year-End unless indicated. LTM = Last Twelve Months.
[3] Moody's Forecasts (f) or Projections (proj.) are Moody's opinion and do not represent the views of the issuer.
Source: Moody's Investors Service

ESG considerations

TELKOM SA SOC LIMITED's ESG Credit Impact Score is Neutral-to-Low CIS-2

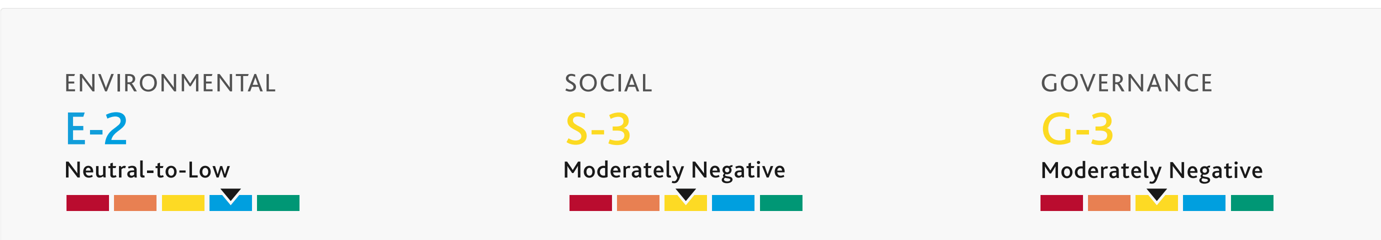
Exhibit 3
ESG Credit Impact Score



Source: Moody's Investors Service

Telkom's ESG Credit Impact Score is Neutral-to-Low (**CIS-2**), meaning ESG attributes have a low credit impact on Telkom's rating. This factors in Telkom's low environmental risk exposure and moderate social and governance risks, which are offset by the company's conservative financial policy and strong management track record. The low credit impact is also caused by the rating being capped by South Africa's sovereign rating.

Exhibit 4
ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

The company's exposure to environmental risks is low and in line with the overall industry. Telkom is mostly focussed on energy efficient projects to reduce energy consumption.

Social

Telkom faces moderately negative social risks as it is exposed to well entrenched labour unions with rigid employee regulations and changing demographic and societal trends towards the use of telecom related technology. This is partially mitigated by Telkom's good track record over the past few years in reducing its overall work force, in particular in its declining fixed voice business and of successfully growing mobile voice and data businesses to offset declining fixed voice revenues. Data security and data privacy issues are prominent in the sector. Telecommunications providers exchange large amounts of data, and a breach could cause legal, regulatory or reputation issues. In addition, a breach could result in increased operational costs to mitigate cyberattacks and reduce exposure to the loss of private data. Electromagnetic radiation (for example, from mobile antennas or mobile handsets) has repeatedly been said to be potentially harmful to the environment and health. While the need for higher mobile data speeds will increase electromagnetic radiation, we do not see it as a significant environmental risk for global telecommunication providers, given the existing regulatory radiation limits and ongoing technology improvements.

Governance

Telkom faces moderate governance risks as the government of South Africa is the largest shareholder with 40.5% ownership. The risk of government interference is low as the government has no board representation and has no track record of active interference in the company's management. Telkom has conservative financial policies and a good track record in adhering to these.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

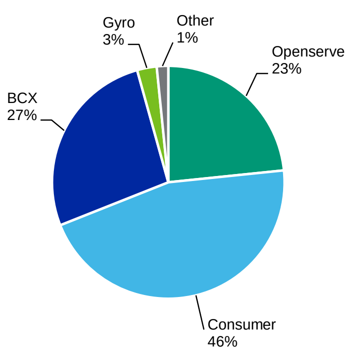
Profile

Telkom is the leading South African fixed-line operator and the third incumbent mobile operator, controlling around 1.1 million fixed telephone access lines, most of which are connected to digital exchanges, and has 16.3 million active mobile subscribers in South Africa, making it the third largest mobile operator in the country by number of subscribers. As of 30 September 2021, the company had the largest national fibre network across South Africa. Telkom operates across four segments: Consumer (mobile, fixed-line and broadband), Business Connection Group (BCX, offering information and communication technology services, ICT), Openserve (wholesale connectivity), and Gyro/ Swiftnet (masts, towers and property portfolio).

Telkom is listed on the Johannesburg Stock Exchange (JSE) and is 40.5% owned by the South African government, 10.5% by the Public Investment Corporation, a South African state-owned investment management company, and the remaining 49.0% is free float, as of 30 September 2021. The company is planning to list a minority stake in Swiftnet on the JSE, following the listing Telkom will continue to consolidate Swiftnet.

Exhibit 5

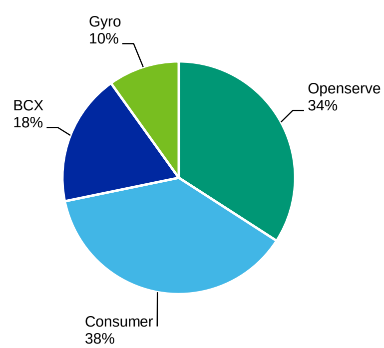
Revenue by business segment
September 2021 LTM



Note: Includes revenue from external customers and intersegmental operating revenue, before intracompany eliminations
Sources: Company information, Moody's Investors Service

Exhibit 6

EBITDA by business segment
September 2021 LTM



Note: Based on company reported EBITDA, before intracompany eliminations and excluding other losses
Sources: Company information, Moody's Investors Service

Detailed credit considerations

Geographic concentration in South Africa

Telkom's revenue and EBITDA are exclusively generated in South Africa, which exposes the company to the economic, political, social, legal and regulatory environment of the country. Growth of the South African economy remains structurally weak, despite some recovery from the pandemic in 2021. We expect medium term growth of only about 1.5% due to constraints from a malfunctioning labour market, decaying infrastructure and slow progress on economic and social reforms. While Telkom's revenue and EBITDA overall remained stable in the face of slow or even negative economic growth, some parts of its business are more dependent on the macroeconomic environment. Particularly the IT segment in the BCX division, which generates revenue from projects for enterprises and public sector entities is exposed to macroeconomic cycles. This business has declined by an average rate of 9% per year since 2017, with the decline particularly accelerating since 2020 as macroeconomic pressures intensified. Also mobile average revenue per user (ARPU) in South Africa remains low, with limited ability to increase while consumer spending power remains under pressure.

In March 2022 the South African telecoms regulator ICASA concluded a spectrum auction that had been delayed for several years. The conclusion of the auction provides more certainty to operators and secures spectrum that had been allocated on a temporary basis during the pandemic, however the new spectrum is unlikely to lead to material growth for South African mobile network operators. Telkom obtained spectrum bands below 1000 megahertz, which offers better indoor coverage as well as some high frequency bands that can be used to roll out 5G.

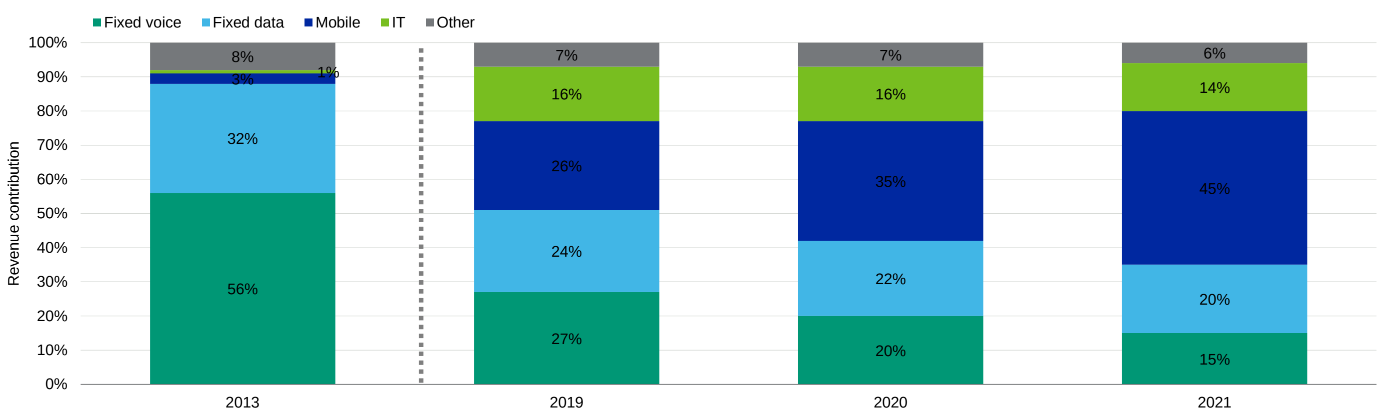
Successful transition to integrated telecommunications business model

Over time Telkom's business model has become increasingly diversified and integrated (see exhibit 7). To offset the steady decline in demand for fixed voice services, which used to be Telkom's main product, the company embarked on a turnaround strategy in 2013 to broaden its service offering. After completion of the strategic turnaround, Telkom remains the leader in fixed telephony and broadband in South Africa, but the company has also built out a sizeable mobile service offering in its consumer division and added enterprise ICT services for businesses and public sector entities through the acquisition of BCX in 2015. Its ICT services include hosting, managed solutions, cloud and data center services. Telkom also has an infrastructure business, including its wholesale broadband network in the Openserve division and Gyro, its property investment and property services business which also includes Swiftnet, its masts and towers portfolio. The infrastructure businesses derive a substantial portion of their revenue from leasing network and tower capacity to other mobile operators and third party clients.

The integrated business model has allowed Telkom to successfully diversify its income streams away from the declining fixed line voice business and positions the company well as a convergent telecom operator. Convergent offerings allow the company to serve a wider range of customers and to provide bundled packages with opportunities to upsell and increase customer loyalty. Nevertheless revenue growth has been slow over the past few years, at an average rate of just 1.3% per year from financial year ending March 2017 to March 2021 and for the six months ending September 2021, revenue declined by 0.5% from the same period a year earlier. Moody's adjusted EBITDA is only 0.7% higher for the twelve months ending September 2021 than it was in March 2017. This slow growth is driven by the combination of continued decline of Telkom's fixed voice service, some cyclicality in the BCX business and a highly competitive and relatively mature mobile market in South Africa that makes it difficult to grow this business faster than the fixed voice business is declining.

Exhibit 7

Evolution of Telkom's revenue mix 2013 to 2021



Sources: Telkom, Moody's Investors Service

After rapid growth of mobile business, future growth prospects are lower in competitive and mature South African mobile market

The mobile business, comprising both voice and data services, has become Telkom's primary revenue driver and accounted for 45% of group revenue for the year ending March 2021, increasing to 49% for the six months ending September 2021. Telkom's mobile business has in the past grown rapidly, from 1.8 million subscribers in March 2014, generating around ZAR350 million in revenue to 16.3 million subscribers and ZAR19.5 billion of revenue for the twelve months ending September 2021. Telkom was able to generate this rapid growth despite competition from three larger, more established mobile operators Vodacom (majority owned by Vodafone Group plc, Baa2 stable), MTN Group Limited (Ba2 stable) and Cell C. Telkom overtook Cell C in terms of subscriber numbers in 2020, becoming the third largest mobile operator in South Africa. Telkom's market share however still significantly lags behind the 30% market share of the second largest operator MTN and its profitability is also significantly lower at a mobile business EBITDA margin of 29% for the six months ending September 2021 against margins generally in excess of 40% for MTN's and Vodacom's South African operations. We expect growth of the mobile segment in South Africa will slow over the next years as the mobile market is mature, as indicated by a penetration rate of 162% as of 2020 according to the World Bank, meaning there are 162 mobile subscriptions for every 100 residents, which is amongst the highest levels in the world. Over the six months to September 2021, subscriber growth continued to be strong at 18.8% against the same period a year earlier, however this was mainly driven by a nearly equivalent 17.9% decline in ARPU, indicating intense pricing pressure to maintain subscriber growth.

Focus on cost savings and network commercialization

For profitability to improve, efficiencies and cost savings are crucial. Telkom is focussed on streamlining and has significantly reduced its workforce in recent years. Profitability was negatively impacted in 2020 due to provisioning for credit losses and the decline in revenues at BCX. As the economy recovers from the pandemic, we expect EBITDA margins to recover back to pre-pandemic levels of 28-29% from 27.4% as of the twelve months ending September 2021. A new roaming agreement with MTN concluded in 2021 will help to reduce roaming costs and improve network coverage.

With growth of the mobile business expected to slow down, Telkom is focussing on cementing its leadership in broadband/ fixed data, which contributes to revenue across its Consumer, BCX and Openserve divisions and which accounts for most of the EBITDA generated by the Openserve division. Openserve accounted for 34% of Telkom's EBITDA for the twelve months ending September 2021 (see exhibit 6) and therefore already constitutes a substantial part of the company's profitability.

Telkom has the largest broadband network across South Africa and continued investment in the network is one of Telkom's key priorities, accounting for 43% of total investments during the six months ending September 2021. During this period, the company increased homes passed with fibre by 54% to more than 707,000 compared to a year earlier and increased the number of homes connected by 34% to nearly 332,000. At the same time the share of customers connected to fibre rather than legacy technologies increased to 59% from 39%. Telkom sees particular demand growth from other carriers for use of its strong backhaul capacity. As Telkom continues its investments in the network and mobile customers' demand for speed and data consumption increases, we expect that demand from other mobile carriers for Telkom's network will continue to grow strongly. At the same time the decline in demand for fixed voice services will level off as the contribution to Telkom's revenues has already reduced substantially. The combination of growth in fixed data and slower decline of fixed voice should over the next 2-3 years lead to a stabilization and eventual growth of revenue and EBITDA from Openserve.

Telkom announced it plans to list its mobile mast and tower portfolio, Swiftnet, on the JSE before the end of March 2022, however this has been delayed due to market volatility. Telkom will maintain majority ownership, control and will continue to consolidate the tower business. We expect both the initial cash raised from the minority listing as well as the resulting ongoing tower lease payments to be small and not to have a meaningful credit impact. Telkom is already commercializing its tower portfolio with an average colocation rate of 1.55x, meaning it is renting out space on a significant number of its towers to other mobile network operators or other third parties. While below the international target norm of 2x, the colocation rate is in line with pan-African and emerging markets independent tower company IHS Holding Limited (B2 stable) and an adequate ratio for a tower portfolio in growth stage.

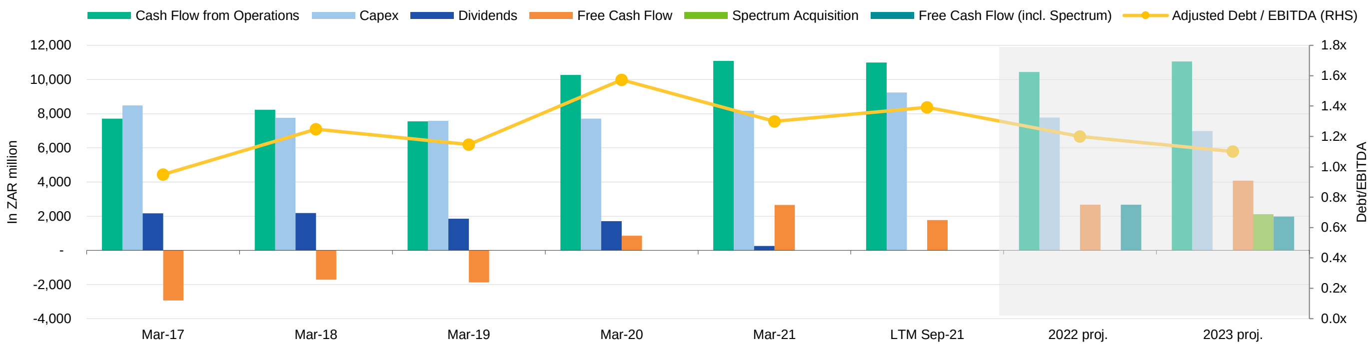
Financial credit metrics remain strong despite operating performance pressures

Telkom has conservative financial policies with target net leverage of 1.0 - 1.2x and a strong track record of complying with financial targets. For the twelve months ending September 2021 net leverage stood at 1.1x. This compares to Moody's adjusted leverage of 1.4x, which we view as low for Telkom. We expect leverage to remain in this range as spectrum payments came in lower at ZAR2.1 billion against Telkom's previous expectation of up to ZAR4 billion. The planned listing of Swiftnet and suspension of dividends, provide Telkom with additional sources of cash flow and flexibility to keep leverage low.

Telkom also has the option to be more prudent in its capital spending over the next 12 months, spending at the lower end of its market guidance between 16% and 20% of revenue and slowing down the migration of copper to fibre. We expect the company will continue to make capital investments a priority over dividends for the coming years.

Exhibit 8

Cash flow generation has improved and allows to keep leverage stable



[1] Cash flow from operations shown excluding dividend payments

[2] 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 Investors Service

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

Moody's default dependence assessment reflects the degree of correlation of a government-related issuer, 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 assumption 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. Despite its 40.5% 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, but will not impact the overall rating position, given Telkom's standalone credit profile as reflected by the ba2 BCA, which is currently in line with that of the Government of South Africa.

Liquidity analysis

We consider Telkom's liquidity profile to be adequate as it benefits from cash and cash equivalents of ZAR3.4 billion as of September 2021. Together with expected operating cash flow of around ZAR10 billion for the next 12 months, this is sufficient to meet its committed obligations over the next 12 months, which include debt maturities, operating expenses and planned capital spending.

In addition, Telkom has access to ZAR5.5 billion of undrawn committed borrowing facilities, most of which are in the form of 360-day evergreen facilities. While we don't consider these as strong sources of liquidity, we note that banks have been routinely rolling over facilities. Some of Telkom's facilities include financial covenants, including interest cover and net leverage, which the company has been able to meet comfortably.

Rating methodology and scorecard factors

The principal methodology used in rating the company was our Telecommunications Service Providers rating methodology published in January 2017. The 2 notch difference between the grid indicated outcome and the Ba2 rating is due to the constraint from the South African sovereign rating.

Exhibit 9

Rating factors

Telkom SA SOC Limited

Scorecard Factors				
Telkom SA SOC Limited				
Telecommunications Service Providers Industry Scorecard [1][2]	Current LTM 9/30/2021		Moody's 12-18 Month Forward View As of 3/30/2022 [3]	
Factor 1 : Scale (12.5%)	**Measure**	**Score**	**Measure**	**Score**
a) Revenue (USD Billion)	$2.9	B	$2.9 - $3	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	Ba	Ba	Ba	Ba
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	1.4x	A	1.1x - 1.2x	A
b) RCF / Debt	64.8%	Aaa	67% - 72%	Aaa
c) (EBITDA - CAPEX) / Interest Expense	1.5x	B	2.1x - 3.5x	Ba
Factor 5 : Financial Policy (15%)				
a) Financial Policy	Baa	Baa	Baa	Baa
Rating:				
a) Scorecard-Indicated Outcome		Baa3		Baa3
b) Actual Rating Assigned				Ba2
Government-Related Issuer	**Factor**			
a) Baseline Credit Assessment	ba2			
b) Government Local Currency Rating	Ba2			
c) Default Dependence	High			
d) Support	Moderate			
e) Actual Rating Assigned	Ba2			

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations
[2] As of 9/30/2021(L); Source: Moody's Financial Metrics™
[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 Investors Service

Ratings

Exhibit 10

Category	Moody's Rating
TELKOM SA SOC LIMITED	
Outlook	Stable
Corporate Family Rating	Ba2
NSR Corporate Family Rating	Aa1.za

Source: Moody's Investors Service

Appendix

Exhibit 11

Moody's-Adjusted Debt Reconciliation for Telkom SA SOC Limited[1][2]

(in ZAR Millions)	FYE Mar-17	FYE Mar-18	FYE Mar-19	FYE Mar-20	FYE Mar-21	LTM Ending Sep-21
As Reported Debt	**6,378**	**9,427**	**10,241**	**16,782**	**15,839**	**16,044**
Pensions	1,151	1,966	752	0	255	255
Operating Leases	3,135	3,312	3,546	0	0	0
Moody's-Adjusted Debt	**10,664**	**14,705**	**14,539**	**16,782**	**16,094**	**16,299**

[1] All figures are calculated using Moody's estimates and standard adjustments.
[2] Periods are Financial Year-End unless indicated. LTM = Last Twelve Months.
Source: Moody's Financial Metrics TM

Exhibit 12

Moody's-Adjusted EBITDA Reconciliation for Telkom SA SOC Limited[1][2]

(in ZAR Millions)	FYE Mar-17	FYE Mar-18	FYE Mar-19	FYE Mar-20	FYE Mar-21	LTM Ending Sep-21
As Reported EBITDA	**10,824**	**10,580**	**10,706**	**9,391**	**11,614**	**11,833**
Pensions	82	84	87	37	35	35
Operating Leases	1,045	1,104	1,182	0	0	0
Unusual	-208	-59	700	1,187	395	-48
Non-Standard Adjustments	0	70	-2	-11	0	0
Moody's-Adjusted EBITDA	**11,743**	**11,779**	**12,673**	**10,604**	**12,044**	**11,820**

[1] All figures are calculated using Moody's estimates and standard adjustments.
[2] Periods are Financial Year-End unless indicated. LTM = Last Twelve Months.
Source: Moody's Financial Metrics TM

Exhibit 13

Peer comparison[1][2]

	Telkom SA SOC Limited Ba2 Stable			MTN Group Limited Ba2 Stable			Millicom International Cellular S.A. Ba1 Stable		
(in US millions)	FYE Mar-20	FYE Mar-21	LTM Sep-21	FYE Dec-19	FYE Dec-20	FYE Dec-21	FYE Dec-19	FYE Dec-20	FYE Dec-21
Revenues	$2,919	$2,656	$2,912	$10,498	$10,967	$12,304	$4,336	$4,171	$4,617
EBITDA	$719	$740	$798	$4,385	$4,587	$5,265	$1,746	$1,631	$2,515
Total Debt	$940	$1,090	$1,083	$10,055	$9,921	$8,071	$7,067	$6,710	$8,912
Cash & Cash Equivalents	$265	$339	$225	$1,555	$2,110	$2,474	$1,164	$875	$895
EBITDA Margin	24.6%	27.9%	27.4%	41.8%	41.8%	44.3%	40.3%	39.1%	54.5%
(EBITDA-CAPEX) / Interest Expense	1.3x	2.4x	1.5x	2.3x	2.6x	3.0x	1.3x	1.1x	2.8x
Debt / EBITDA	1.6x	1.3x	1.4x	2.2x	1.9x	1.6x	4.1x	4.1x	3.5x
FCF / Debt	0.4%	11.2%	5.4%	-3.5%	10.1%	18.7%	-3.6%	-0.8%	-0.5%
RCF / Debt	39.6%	60.5%	64.8%	25.8%	34.1%	44.8%	11.6%	11.8%	10.9%

[1] All figures & ratios calculated using Moody's estimates & standard adjustments.
[2] FYE = Financial Year-End. LTM = Last Twelve Months. RUR* = Ratings under Review, where UPG = for upgrade and DNG = for downgrade.Source: Moody's Financial MetricsTM
Source: Moody's Financial Metrics TM

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