MOODY'S
INVESTORS SERVICE

CREDIT OPINION
3 December 2020

Update

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RATINGS

Telkom SA SOC Limited

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

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 sovereign rating action on South Africa

Summary

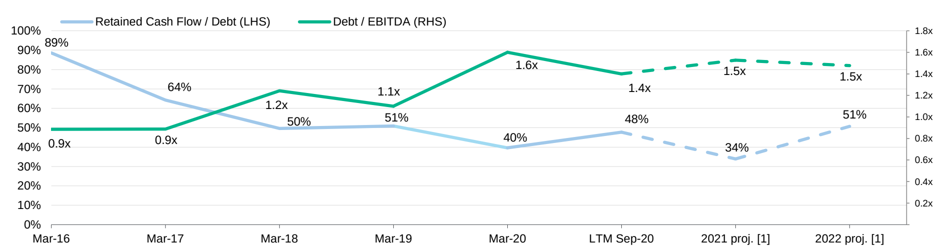
On 26 November 2020, we downgraded the corporate family rating of Telkom SA SOC Limited (Telkom) to Ba2 from Ba1, lowered the baseline credit assessment (BCA) to ba2 from ba1 and affimed the national scale rating at Aa1.za, the outlook remains negative. The downgrade directly follows the downgrade of the rating of the government of South Africa to Ba2, negative outlook on 20 November 2020 and reflects Telkom's 100% operational concentration in South Africa. Despite having very strong credit metrics and adequate liquidity, Telkom derives all of its revenues from South Africa and therefore its credit standing is strongly correlated to the economic environment in the country. The low growth environment combined with potential future delays around the implementation of a shared infrastructure network (WOAN) and allocation of new spectrum, will be a growth constraint to South African mobile network operators.

Telkom's Ba2/Aa1.za coporate family ratings reflect our view of the fundamental credit quality of Telkom, represented by its Baseline Credit Assessment (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 entity because it is 40.5% owned by the Government of South Africa.

Telkom's BCA of ba2 recognizes the company's leading market position in South Africa's fixed-line business, with a growing presence in broadband and mobile offerings. It also reflects the transformation process of its business model and the execution challenges faced in the implementation of strategies to offset the structural decline in voice revenues.

Exhibit 1

Strong credit metrics and low leverage offset business risk



[1] 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

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 and growing mobile business which mitigate declining voice revenue

» Strong credit metrics and liquidity

Credit challenges

» Third largest operator in the highly competitive South African mobile market

» Structural decline in fixed-line voice revenue

» Execution risk around Telkom's convergence strategies

Rating outlook

The negative outlook reflects Telkom's 100% operational concentration in South Africa, exposing the company to the heightened risks associated with the operating environment in South Africa. The outlook could be changed to stable if the Government of South Africa's rating is changed to stable.

Factors that could lead to an upgrade

Given the negative outlook, an upgrade is unlikely in the near-term. The outlook could be changed to stable if the Government of South Africa's rating outlook is changed to stable. Subject to an upgrade of the South African government bond rating, an upgrade of Telkom's ratings could be considered, if Telkom reduces its reliance on structurally declining voice revenue and Moody's adjusted debt/ EBITDA sustainably remains below 2.5x.

Factors that could lead to a downgrade

Telkom's ratings are likely to be downgraded in case of a further downgrade of South Africa's sovereign rating, 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 3.5x on a sustained basis or retained cash flow/total debt falls below 20% on a sustained basis.

Key indicators

Exhibit 2

Telkom SA SOC Limited [1]

	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	LTM Sep-20	2021-proj. [2]	2022-proj. [2]
Revenue (ZAR Billion)	37.3	41.0	39.7	41.8	43.0	43.0	42.8	44.6
Debt / EBITDA	0.9x	0.9x	1.2x	1.1x	1.6x	1.4x	1.5x	1.5x
RCF / Debt	88.6%	64.3%	49.3%	50.9%	39.6%	47.7%	33.9%	50.7%
(EBITDA - CAPEX) / Interest Expense	5.3x	2.6x	2.6x	3.5x	1.4x	2.8x	3.8x	2.4x

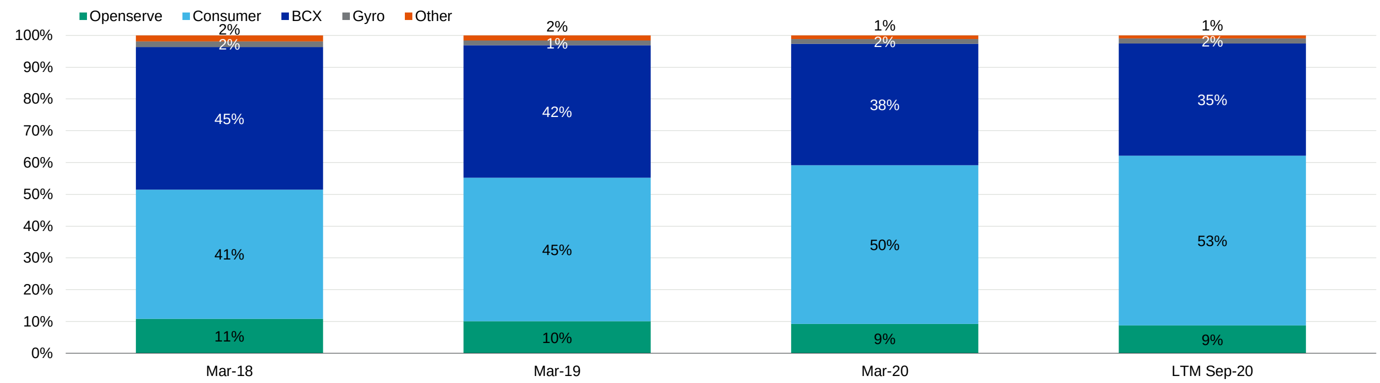
[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] This Represents Moody's forward view, not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.
Source: Moody's Investors Service

Profile

Telkom SA SOC Limited (Telkom) is the dominant South African fixed-line operator and the third incumbent mobile operator, controlling around 1.5 million telephone access lines, most of which are connected to digital exchanges, and has 13.7 million active mobile subscribers, representing around 14% of the South African mobile market. As of 30 September 2020, the company had the largest national fibre network across South Africa. Telkom operates across five segments: Consumer (mobile, fixed-line and broadband), Business Connection Group (BCX, offering ICT services), Openserve (wholesale data), Yep! (digital online services), and Gyro (masts and towers property portfolio).

Telkom is listed on the Johannesburg Stock Exchange 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 2020.

Exhibit 3
Evolution of Telkom's revenue split by business segment



Sources: Telkom, Moody's Investors Service

Detailed credit considerations

Leading fixed-line operator with competitive mobile segment

Our rating captures Telkom's dominant position as a provider of fixed-line operations, which is balanced by its growing mobile operations, and 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, and such a model is more robust and de-risks revenue compared with a single platform. This is mainly because Telkom can target a wider array of customers and segments, and is able to provide bundled packages, which single platform operators cannot. As a strong fixed-line and broadband incumbent, and as the third largest company 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 the competition in South Africa is high because mobile operators pursue similar convergent strategies and fibre operators expand their networks and compete directly with Telkom. Telkom has implemented various measures to defend its market position, which include (1) improving the customer experience, (2) winning back traffic through fixed-to-mobile convergence and more competitive bundled packages and pricing tariffs, (3) leveraging next-generation network (NGN) technology to provide high-quality broadband and aggressive rollout of fibre past the home (2.9 million premises passed, of which 458,791 are fibre to the home and 2,411,661 are fibre to the cabinet), and (4) encouraging customers to move to annuity-based bundles and calling plans. These measures have largely been successful and have improved the quality of cash flow and reduced its dependence on fixed-line voice revenue.

Evolving business model mitigates fixed-line voice revenue decline

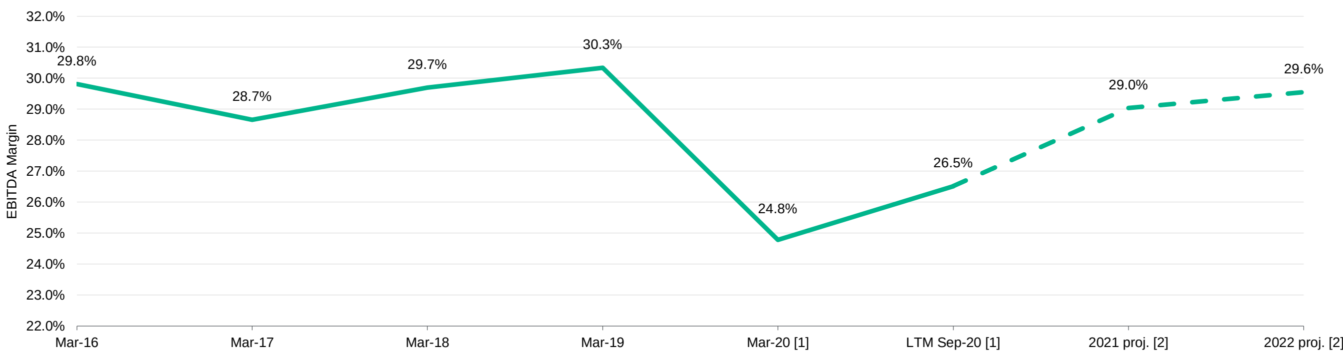
Telkom's fixed-line subscriber and usage continues its structural decline as customers migrate to mobile and broadband services and move consumption to data from voice. The COVID-19 pandemic has further accelerated this trend, as more customers work from home using mobile data rather than business' fixed connections.

Telkom has been successful in maintaining revenues and profitability by pursuing a transformational strategy, focussed on cost optimization, growth of its mobile business and continued investment in its fibre network. For the six months ending September 2020, the share of group revenue generated from mobile services increased to 44%, up from 33% a year earlier and overtaking group revenues generated from fixed services. For the first time Telkom also passed competitor Cell C's mobile subscriber numbers and has become the 3rd mobile operator in South Africa.

Part of Telkom's realignment strategy also aims to establish itself as the leading South African converged (fixed/mobile voice and data) communication provider through the provisioning of a range of hosting services, managed solutions, mobile voice and wireless broadband services. Further, the acquisition of BCX in September 2015 helped Telkom increase its ICT services to include cloud-based and data centre services, and bolster its lagging business/enterprise solutions offerings. The BCX acquisition has also diversified Telkom's revenue base towards alternative services and has made it less reliant on voice revenue. For the six months ending 30 September 2020, BCX contributed 31% of group revenues and the share generated by voice continued its structural decline to 24% compared to 41% in fiscal 2016.

The Moody's adjusted EBITDA margin dropped for the year ended March 2020 due to a material increase in provisioning for credit losses as a result of the COVID pandemic. Some of the provisions have since been released and for the 12 months ending September 2020, the adjusted EBITDA margin has started to recover. The margin recovery was also helped by a mix effect that increased the share of higher margin mobile and decreased the share of the BCX business resulting from COVID related changes in consumption patterns and due to cost savings. We expect EBITDA margin to recover to pre-pandemic levels, but to remain flat against historic levels, given the expected ongoing weak economic environment in South Africa.

Exhibit 4
EBITDA margin is likely to remain lower due to weak economic environment



[1] Mar-20 and LTM Sep-20 EBITDA include a material increase in expected credit loss provision
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

The implementation of the turnaround strategy to stabilise the business, which began in 2013, has been completed. Telkom is now focused on growing the businesses to become the leading telecommunications provider of converged services which carried and element of execution risk given the challenging macroeconomic environment in South Africa. To facilitate and drive its strategy further, Telkom has implemented a more flexible and agile operating model and restructured its operations into five distinct and independent operating divisions, namely Openserve, BCX, Telkom consumer, Gyro and Yep!. This ensures that management in the various divisions is more targeted in its cost deployment and strategies, leading to greater accountability.

We expect Telkom to continue to focus on organic growth, with both smaller bolt-on acquisitions and appropriately prized larger opportunities, as management focuses on enhancing its existing operations. Depending on the size, acquisitions will be financed with a combination of operating cash flow, debt and equity and ensuring that Telkom maintains a conservative capital structure and healthy balance sheet. Acquisitions will only be pursued if it gives the company access to an operation that has sizeable market positions in its respective sector.

The telecoms industry faces ongoing delays with regard to updated regulation in South Africa. There are a number of critical regulatory decisions that may affect Telkom that are difficult to assess at this stage, namely (1) upcoming spectrum allocations, whereby access to spectrum below 1000 megahertz would offer a greater coverage with less infrastructure requirements for Telkom; and (2) implementation of government plans for a wholesale open access network (WOAN).

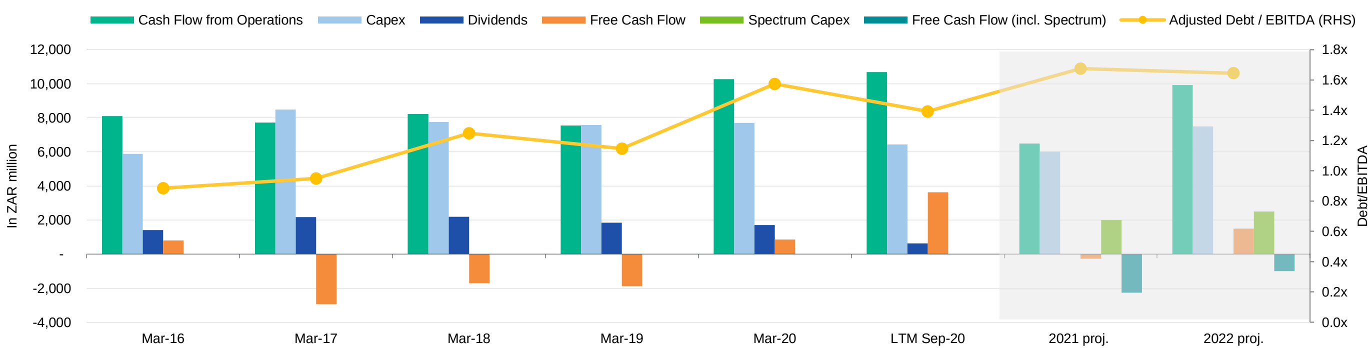
Financial credit metrics remain strong despite operating performance pressures

Despite declining fixed-line voice revenue, Telkom's operating results have been relatively stable. Due to the economic environment and coronavirus pandemic we expect GDP in South Africa to decline by 6.5% in 2020, before recovering by 4.5% in 2021. Against this backdrop we expect Telkom's revenue for fiscal 2021 (ending March 2021) to decline slightly but with EBITDA margin holding up well as demonstrated in September 2020 results. We expect Telkom to maintain its conservative financial policies and preserving its strong financial credit profile. Management has maintained stable metrics, with reported net debt to EBITDA of 1.0x (post IFRS 16) as of September 2020 down from 1.4x a year earlier, which is in line with the board target of around 1.0x-1.2x. Leverage could increase again slightly going forward, as Telkom has announced it expects to pay c. ZAR4 billion in South Africa's spectrum auction at the beginning of calendar year 2021. We expect Telkom to remain in compliance with its leverage targets though by not paying a dividend for the time being and by partially financing spectrum acquisitions with proceeds from a planned transaction to unlock equity from its Gyro towers portfolio.

Telkom also has the flexibility 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 also expect the company to remain prudent with its dividend policy and to make capital investments a priority over dividends for the coming years.

Exhibit 5

Expected moderate increase in leverage due to negative free cash flow after accounting for spectrum acquisition



[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 ZAR3.9 billion as of September 2020 and expected positive operating cash flow of around ZAR6.7 billion for the next 12 months. This is sufficient to meet its committed obligations over the next 12 months, which include debt maturities, restructuring costs and planned capital spending.

In addition, Telkom has access to ZAR5.5 billion of undrawn committed borrowing facilities with varying maturities. ZAR 4 billion of the committed facilities is in the form of 360-day evergreen facilities, which increases the group's reliance on shorter-term funding. The facilities are 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 we analyse the credit risk of telecommunications companies and arrive at their ratings. We expect the grid implied ratings to remain at Baa3. The 2 notch difference reflects the South African sovereign rating constraint.

Exhibit 6

Rating Factors

Telkom SA SOC Limited

Scorecard Factors				
Telkom SA SOC Limited				
Telecommunications Service Providers Industry Scorecard [1][2]	**Current LTM 9/30/2020**		**Moody's 12-18 Month Forward View As of 11/26/2020 [3]**	
Factor 1 : Scale (12.5%)	**Measure**	**Score**	**Measure**	**Score**
a) Revenue (USD Billion)	$2.7	B	$2.7 - $2.9	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	1.4x	A	1.5x - 1.7x	A
b) RCF / Debt	47.7%	Aa	34% - 51%	A
c) (EBITDA - CAPEX) / Interest Expense	2.8x	Ba	2.4x - 3.8x	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 LTM 09/30/2020.
[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 7

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

Source: Moody's Investors Service

Appendix

Exhibit 8

Peer comparison
Telkom SA SOC Limited

	Telkom SA SOC Limited Ba2 Negative			MTN Group Limited Ba2 Negative			Telefonica Brasil S.A. Ba1 Stable		
(in US millions)	FYE Mar-19	FYE Mar-20	LTM Sep-20	FYE Dec-18	FYE Dec-19	LTM Jun-20	FYE Dec-18	FYE Dec-19	LTM Sep-20
Revenues	$3,049	$2,919	$2,669	$10,223	$10,498	$10,498	$11,972	$11,243	$9,114
EBITDA	$925	$724	$708	$4,492	$4,385	$4,605	$5,927	$4,774	$3,867
Total Debt	$1,008	$940	$951	$12,678	$10,055	$9,498	$4,111	$3,244	$2,122
Cash & Cash Equivalents	$99	$265	$235	$1,101	$1,555	$1,668	$872	$844	$1,483
EBITDA Margin	30.3%	24.8%	26.5%	43.9%	41.8%	43.9%	49.5%	42.5%	42.4%
(EBITDA-CAPEX) / Interest Expense	3.5x	1.4x	2.8x	1.7x	2.3x	2.7x	6.6x	9.6x	11.9x
Debt / EBITDA	1.1x	1.6x	1.4x	3.1x	2.2x	2.3x	0.7x	0.7x	0.7x
FCF / Debt	-12.9%	0.4%	17.7%	-4.3%	-3.5%	1.3%	-4.5%	20.7%	44.2%
RCF / Debt	50.9%	39.6%	47.7%	18.9%	25.8%	23.5%	104.5%	90.5%	101.1%

[1] All figures are calculated using Moody's estimates and standard adjustments. FYE = Financial year-end. LTM = Last 12 months.
[2] MTN Group Limited's Ba2 rating is constrained by the Government of South Africa's rating (Ba2 negative), Telefonica Brasil S.A.'s Ba1 rating is constrained by the Government of Brazil's rating (Ba2 stable).
Source: Moody's Investors Service

Exhibit 9

Moody's-adjusted debt breakdown
Telkom SA SOC Limited

(in ZAR Millions)	FYE Mar-16	FYE Mar-17	FYE Mar-18	FYE Mar-19	FYE Mar-20	LTM Ending Sep-20
As Reported Debt	**5,275**	**6,378**	**9,427**	**10,241**	**16,782**	**15,856**
Pensions	1,274	1,151	1,966	752	0	0
Operating Leases	3,300	3,135	3,312	3,546	0	0
Moody's-Adjusted Debt	**9,849**	**10,664**	**14,705**	**14,539**	**16,782**	**15,856**

[1] All figures are calculated using Moody's standard adjustments. FYE = Financial year-end.
Source: Moody's Investors Service

Exhibit 10

Moody's-adjusted EBITDA breakdown
Telkom SA SOC Limited

(in ZAR Millions)	FYE Mar-16	FYE Mar-17	FYE Mar-18	FYE Mar-19	FYE Mar-20	LTM Ending Sep-20
As Reported EBITDA	**8,952**	**10,824**	**10,580**	**10,706**	**9,545**	**9,715**
Pensions	-626	82	84	87	37	37
Operating Leases	1,100	1,045	1,104	1,182	0	0
Unusual	1,701	-208	-59	700	1,187	1,640
Non-Standard Adjustments	0	0	70	-2	-11	0
Moody's-Adjusted EBITDA	**11,127**	**11,743**	**11,779**	**12,673**	**10,667**	**11,392**

[1] All figures are calculated using Moody's standard adjustments. Financial year-end.
Source: Moody's Investors Service

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