Telkom

2020

Telkom SA SOC Ltd
Annual Results

for the year ended
31 March 2020

Key highlights

Strong **mobile service** revenue increase of **54.4%** **driving growth**

Customer base up **23.9%** to **12 million** with net **additions of 1.9 million**

FTTH connectivity rate up **48.2%** **highest in the market**

FCF improved threefold to **R2.0 billion**

Strengthened balance sheet with net debt EBITDA **less than 1x** excluding IFRS 16 and once-off items

Telkom SA SOC Ltd (Registration Number 1991/005476/30) | JSE share code: TKG | JSE bond code: BITEL | ISIN: ZAE000044897 ("Telkom" or "the company")
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Telkom operates in a constantly evolving environment where advances in technology and changing customer needs are impacting traditional revenue streams and requiring the business to transform for long-term growth. Our group performance depicts the evolution of technology and revenue mix. Notwithstanding the decline in our fixed business that impacted EBITDA, Telkom delivered solid performance with the mobile business driving growth. FCF improved threefold and our balance sheet strengthened.

COVID-19 impact

This year was characterised by a tough economic environment where we saw our country slipping into a technical recession and being massively impacted by the global pandemic COVID-19. This year also concludes a challenging decade of depressed economic growth, currency volatility, technology disruption, increasing competition and regulatory uncertainty – none of which Telkom has been spared from.

COVID-19 impacted the last two weeks of FY2020. In line with the JSE and SAICA guidance, COVID-19 has been concluded as an adjusting post balance sheet event for companies with a year end of 31 March 2020. IFRS 9 requires that the impairment of trade receivables and contract assets be based on expected credit loss (ECL) principles, which require us to take a forward-looking view of a macro-economic impact on debtors' behaviour. Telkom took a prudent approach in line with the ECL principles and recognised a total provision of R1.1 billion in this financial year relating to the impairment of trade receivables and contract assets, of which R626 million is due to the expected impact of COVID-19. This negatively impacted our results for FY2020. Notwithstanding the expected economic challenges as a result of COVID-19, Telkom has not seen a deterioration in its debtor's book performance from March 2020 to May 2020.

Group performance

Our group performance depicts the evolution of technologies and revenue mix. Group revenue grew 3.0% to R43.0 billion despite a 22.2% decline in fixed voice revenue. The ongoing capex investment enabled Telkom to grow new revenue streams and showed growth in evolving technology, offsetting the traditional business decline. Mobile, information technology (IT) and masts and towers contributed positively to group revenue. Capex of R7.8 billion, with capex to revenue of 18.0%, underpins revenue growth. We focused our investment programmes on key growth areas and we are seeing good returns, with mobile service revenue increasing by 54.4% and the connectivity rate for fibre to the home (FTTH) improving from 38.4% in the prior year to 48.2% in the current year – the highest in the market.

The mobile business grew 54.4% in service revenue from a higher base to R12.6 billion to remain the fastest growing mobile business in South Africa with 12 million customers. This was underpinned by our ongoing network investment and successful broadband-led propositions, which continue to resonate well with customers. Despite ongoing competitive threats with changes implemented by our competitors in the mobile space, our broadband-led propositions are market leading, being best in class for value and effective pricing. The mobile business remains profitable, with its EBITDA margin improving from 1.4% to 14.9%*** over the past three years. On a reported basis, the mobile EBITDA margin for the year ended 31 March 2020 is 18.6%.

The BCX IT business contributed positively to group revenue, despite the challenging economic environment BCX operates in. The performance was supported by the drive to grow the industry-specific owned intellectual property.

The strategy to separate our property and mast and tower portfolio to increase management focus and unlock value for the group continues to be successful. Gyro contributed positively to the group revenue, driven by our mast and tower portfolio as the demand for external leases increases.

Our challenge for the year was the impact of the fixed voice revenue on group EBITDA as the decline intensified. The growth in new revenue streams was not sufficient to offset the decline caused by high margin fixed voice on group EBITDA. Over time, as the revenue mix evolves, we expect the contribution from the fixed voice revenue to reduce and the contribution from the mobile business, with improved EBITDA to increase and offset the impact of fixed voice on group EBITDA. Until the inflection point, management will focus on sustainable cost management to protect the profitability of the business.

In line with this technology shift, the business requires a new skill set to respond to customer needs. Telkom offered Telkom offered voluntary early retirement packages (VERP) and voluntary severance packages (VSP) to 2 271 employees at a cost of R1 186 million in the current year. 75% of these employees took early retirement packages. There were no retrenchments in the current year.

To mitigate the pressure on free cash flow (FCF), Telkom implemented working capital optimisation initiatives. We are pleased that, despite the margin pressure experienced, our FCF improved threefold to R2.0 billion compared to the previous year. We will continue to focus on Telkom's liquidity during this tough trading environment.

During the year we strengthened our balance sheet, refinancing debt at a cheaper rate and repaying maturing debt totalling R1.2 billion. As a result, our gearing improved in the second half of the year, with net debt to EBITDA reducing to 0.7x* (1.3x on a reported basis). The net debt to EBITDA ratio was also positively impacted by the liquidation of the short-term investment of R1.5 billion to fund phase one of the restructuring programme and a significant improvement of approximately R1.4 billion in our FCF compared to the prior year.

Group EBITDA impacted by the decline in fixed voice business

On a pro forma International Accounting Standard (IAS) 17 basis, group EBITDA decreased by 8.7%* to R10 330 million*, with an EBITDA margin of 24.0%*. This is attributable to the change in the revenue mix as high margin fixed business is replaced by new revenue streams at lower margins. Notwithstanding the impact of fixed voice revenue on group EBITDA, management contained the growth in operating expenses at below inflation as the benefits of the headcount restructuring programme implemented in the previous year were realised, despite an average annual salary increase of 6% implemented on 1 April 2019. Direct expenses relating to our mobile business were optimised from 52.6% direct cost to revenue ratio reported in the first half to 44.3% in the second half of the year, resulting in improved mobile business profitablity.

Group HEPS mainly impacted by once-off items

Reported HEPS decreased 66.4% to 208.1 cents per share and reported BEPS decreased 78.4% to 121.1 cents per share impacted by once off costs relating to VSP and VERP costs, COVID-19 and a higher effective tax rate.

On a pro forma IAS 17 basis, HEPS decreased 30.2% to 504.6 cents and BEPS decreased 37.2% to 417.7 cents impacted by lower EBITDA as a result of the impact of the decline in fixed voice as well as the increase in finance charges and fair value movements.

Declaration of dividend

Our current dividend policy is to pay an annual dividend of 60% of headline earnings with an interim dividend of 40% of interim headline earnings. In line with our dividend policy, the board declared a final ordinary dividend number 26 of 50.08410 cents per share. This follows an interim dividend of 71.52636 cents per share in the interim results. This takes the annual dividend for FY2020 to 121.61046 cents per share (FY2019: 361.54461 cents per share).

The declared dividend is payable on Monday, 13 July 2020 to shareholders recorded in the register of the company at close of business on Friday, 10 July 2020. The dividend will be subject to a local dividend withholding tax rate of 20%, which will result in a net final dividend of 40.06728 cents per ordinary share to those shareholders not exempt from paying dividend withholding tax. The ordinary dividend will be paid out of available cash balances.

The number of ordinary shares in issue at the date of this declaration is 511 140 239. Telkom SA SOC Ltd's tax reference number is 9/414/001/710.

Salient dates with regard to the ordinary final dividend

Declaration date	Monday, 22 June 2020
Last date to trade cum dividend	Tuesday, 7 July 2020
Shares trade ex-dividend	Wednesday, 8 July 2020
Record date	Friday, 10 July 2020
Payment date	Monday, 13 July 2020

Share certificates may not be dematerialised or rematerialised between Wednesday, 8 July 2020 and Friday, 10 July 2020, both days inclusive.

On Monday, 13 July 2020, dividends due to holders of certificated securities on the South African register will be transferred electronically to shareholders' bank accounts.

Dividends in respect of dematerialised shareholders will be credited to shareholders' accounts with their relevant central securities depository participant or broker.

Suspension of the dividend policy

Telkom indicated in the first half of the year that it will review the dividend policy, and in considering the new dividend policy Telkom will prioritise its capital investment programme, maintain a healthy balance sheet and consider its cash position within its capital allocation framework. The imminent spectrum auction will require a substantial amount of capital and it is of strategic importance for Telkom to participate to ensure the sustainability of the mobile business. Preserving cash and maintaining a flexible balance sheet have become of critical importance and urgent during the COVID-19 pandemic as the economy is under strain.

Given all these factors that are expected to impact Telkom, the board found it prudent to suspend the dividend policy for the next three years from FY2021. Over the next three years, the capital will be redirected to the acquisition of spectrum and to complete the key capex programme to ensure the sustainability of our business.

Withdrawal of market guidance

The lockdown response to the COVID-19 pandemic is expected to impact the South African economy significantly, but quantifying the likely magnitude of this unprecedented crisis is challenging. Against the backdrop of both exceptional economic weakness and heightened uncertainty, it will be difficult to maintain our medium-term targets. The board found it prudent to withdraw our medium-term targets in FY2021 to allow sufficient time to fully understand and quantify the impact of COVID-19 on the Telkom Group.

Outlook

During this time of uncertainty, management will relentlessly focus on cost savings through its sustainable cost management programme, which includes the restructuring programme and other cost levers to protect the profitability of the business. The full benefits of the two-phase restructuring programme are expected to flow in over the next 12 to 24 months. Management will continue to exercise discipline in allocating capex, making sure that we invest in projects that give us reasonable returns. We are cognisant that COVID-19 may have a negative impact on our business. Therefore, we will continuously assess the capex spend in line with revenue forecasts. Management will continue to focus on cash release initiatives through optimisation of working capital to ensure that we generate positive FCF.

Sello Moloko
Chairman

Sipho Maseko
Group chief executive officer

Tsholofelo Molefe
Group chief financial officer

Pro forma financial information

All commentary, messaging and indicators in the report for the year ended 31 March 2020 are presented on an IAS 17 basis for comparative purposes and exclude VSP and VERP costs of R1 186 million and the related tax impact of R332 million, and the additional impairment of financial assets as a result of COVID-19 of R626 million and the related tax impact of R175 million. FY2019 excludes VSP, VERP and section 189 costs of R728 million and the related tax impact of R215 million.

March 2020

Category	IAS 17 (previous standard)	IFRS 16 (new standard)	Impact
Balance sheet	Lease smoothing receivable/ payable	Recognise right of use of asset Recognise lease liability	R4.5 billion R4.8 billion
Income statement	Operating lease on straight-line basis in operating expenses	Reduced operating lease (higher EBITDA) Depreciation on right-of-use asset Interest expense on lease liabilities Profit after tax (PAT) HEPS	R1 084 million (R954 million) (R368 million) (R171 million) (34.4 cents)
Cash flow	Lease payment in operating activities	Lease payment in financing activities	Reclassification on cash flow statement
Net debt/ EBITDA	Operating lease payment in EBITDA	Higher EBITDA Higher net debt	Increase by 0.4x to 1.3x

Financial information summary	Reported IFRS 16 March 2020 Rm	Pro forma IAS 17* March 2020 Rm	Pro forma* March 2019 Rm	Variance** %
Revenue	43 043	43 043	41 774	3.0
EBITDA	9 602	10 330	11 309	(8.7)
EBITDA margin (%)	22.3	24.0	27.1	–
Capex	7 755	7 755	7 674	1.1
FCF	1 782	1 957	534	266.5
Net debt	12 054	7 279	8 813	17.4
BEPS (cents)	121.1	417.7	665.1	37.2
HEPS (cents)	208.1	504.6	722.4	(30.2)
Net debt to EBITDA (times)	1.3	0.7	0.8	0.1
Final dividend (cents)	50	50	249	(79.9)

* *Based on information for the current and prior years, as well as pro forma information for comparative purposes as defined on pages 5-7 in the Telkom SA SOC Ltd Abridged Annual Results for the year ended 31 March 2020.*

** *Pro forma IAS 17 March 2020 vs pro forma March 2019.*

*** *Excludes the impact of IFRS 16 and the additional impairment of trade receivables and contract assets as a result of COVID-19.*

Pro forma financial information: Certain information presented in this results announcement was prepared excluding the impact of the adoption of IFRS 16 (Leases), the additional impairment of financial assets as a result of COVID-19, VERP, VSP costs in the current period, and voluntary early retirement package (VERP), voluntary severance package (VSP), and section 189 costs in the comparative period and the related tax impact on results and free cash flow (the "pro forma adjustments"). This constitutes pro forma financial information to the extent that it is not extracted from the segment disclosure included in the Telkom audited consolidated abridged financial statements for the year ended 31 March 2020. This pro forma financial information has been presented to eliminate the impact of the pro forma adjustments from the consolidated financial results for the year ended 31 March 2020 to achieve a comparable period-on-period analysis and show the underlying performance of the business. The pro forma adjustments have been determined in terms of the group accounting policies disclosed in the audited consolidated abridged financial statements for the year ended 31 March 2020, except for the changes in accounting policies as a result of the adoption of the accounting pronouncements effective 1 January 2019. Due to its nature, the pro forma financial information is for illustrative purposes only and may not fairly present Telkom's financial position, changes in equity, results of operations or cash flows. The short-form announcement is the responsibility of the directors.

Further information: The Telkom audited consolidated abridged financial statements for the year ended 31 March 2020 contained in the Telkom SA SOC Limited Group Abridged Annual Results for the year ended 31 March 2020 are prepared in accordance with the requirements of the JSE Limited Listings Requirements for abridged reports, and the requirements of the Companies Act applicable to summary financial statements. The Listings Requirements require abridged reports to be prepared in accordance with the framework concepts and the measurement and recognition requirements of International Financial Reporting Standards (IFRS) and the SAICA Financial Reporting Guides as issued by the Accounting Practices Committee and Financial Pronouncements as issued by the Financial Reporting Standards Council and to also, as a minimum, contain the information required by IAS 34 Interim Financial Reporting. The accounting policies applied in the preparation of the Telkom annual financial statements for the year ended 31 March 2020 from which the Telkom audited consolidated abridged financial statements for the year ended 31 March 2020 were derived are in terms of IFRS and are consistent with those accounting policies applied in the preparation of the previous consolidated annual financial statements. The short-form announcement is only a summary of the information in the Telkom annual financial statements for the year ended 31 March 2020 and does not contain full or complete details.

This announcement does not include the information required pursuant to paragraph 16A(j) of IAS 34. Telkom SA SOC Ltd Group Abridged Annual Results for the year ended 31 March 2020 is available on the issuer's website, at the issuer's offices and upon request. The directors take full responsibility and confirm that this information has been correctly extracted from the underlying report.

This announcement is itself not audited but is extracted from the underlying audited information.

The Telkom audited consolidated abridged financial statements for the year ended 31 March 2020 contained in the Telkom SA SOC Ltd Group Abridged Annual Results for the year ended 31 March 2020 have been audited by PricewaterhouseCoopers Inc. and SizweNtsalubaGobodo Grant Thornton Inc., who expressed an unmodified opinion thereon. The auditor also expressed an unmodified opinion on the annual financial statements from which the Telkom audited consolidated abridged financial statements for the year ended 31 March 2020 were derived.

A copy of the auditor's report on the Telkom audited consolidated abridged financial statements for the year ended 31 March 2020 and of the auditor's report on the Telkom annual financial statements for the year ended 31 March 2020 are available for inspection at the company's registered office, together with the financial statements identified in the respective auditor's reports, which sets out key audit matters and the basis for its unmodified opinion is available at: www.telkom.co.za/ir/financial/ financial-results-2020.shtml.

The pro forma financial information in the Group Abridged Annual Results for the year ended 31 March 2020 has been reviewed by the group's joint independent external auditors and should be read in conjunction with that document.

Any investment decisions should be based on the Telkom annual financial statements for the year ended 31 March 2020 published on the JSE's website on Monday, 22 June 2020 and also available on Telkom's website at: www.telkom.co.za/ir.

The Telkom annual financial statements for the year ended 31 March 2020 are available on the company's website at: https://www.telkom.co.za/ir/financial/financial-results-2020.shtml and on the JSE's website at: https://senspdf.jse.co.za/documents/2020/jse/isse/TKG/ye2020.pdf

The Telkom annual financial statements for the year ended 31 March 2020 is furthermore available for inspection at the company's registered address and the offices of the JSE sponsor (Nedbank CIB) during office hours at no charge to shareholders.

Copies of the Telkom annual financial statements for the year ended 31 March 2020 may be requested including full details on how such request can be made.

The distribution of the Telkom annual financial statements for the year ended 31 March 2020 as well as the notice of AGM will follow and will be announced on SENS.

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