Conference call transcript

10 November 2020

INTERNATIONAL ANALYST CALL

Operator

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

Sipho Maseko

Thank you very much, Claudia. Thank you very much, and thanks to everybody on the call, and good morning to those in the US and good afternoon to everybody everywhere else. With me I have Tsholo Molefe, our group CFO. I have Babalwa George, our Head of IR. I'd like to start with unpacking a bit of our results that we presented this morning. There are a couple of themes I will follow. I will share how Telkom played its role to support during the COVID-19 pandemic. I will also unpack how each of our businesses were impacted by COVID-19 and how each one of them responded. Tsholo will then unpack the financial performance and how we are continuing to build financial resilience. I will then come back to address the regulatory environment as the country prepares for the release of spectrum on a permanent basis, and also about the value unlock initiative that we have started.

So, we played a key role as a good corporate citizen to support all of our stakeholders during the height of the COVID-19 period. We spent roughly about R80 million related to COVID-19 spend since the beginning of the lockdown in March to support our employees, to support the country as a whole so that we can be able to weather the crisis. First and foremost we focussed on our employees. We provided testing facilities for our employees. We provided counselling facilities for those that would have been infected and their families through our wellness partner, ICAS. At our peak actually we had about 90% of our employees working from home. At the moment we have roughly about 80% who are still working from home since the beginning of the national lockdown. Of our employees who would have been infected we saw a recovery rate of about 92%. And we continued to ensure that our employees feel safe and supported as they are members of society on an ongoing basis.

We also supported a number of healthcare initiatives and education initiatives. We launched our own education platform, Lightbulb, and zero rated approximately 1,000 education sites to support students of higher learning working with the various national departments. From a health perspective we developed the track and trace tool with the NICD and the Department of Health which has been initially used in the process of tracking and identifying various potentially infected citizens. And then our customers were impacted as well in different ways. We put some reduced data prices into the market. We increased bundle sizes and speeds to assist customers to meet their data needs. On the BCX side and small and medium business we granted extended payment terms to assist them. And in return we'd be able to secure something like 12 to 24 month contract extension.

We also worked closely with the Red Cross in terms of health education and making sure that we were able to reach as many people as possible during that time. We also made some of our facilities available as additional quarantine sites to assist government to accommodate those who were infected and could not quarantine from home. So those are some of the things that we did, and we actually think that Telkom as a whole showed up in the right way in the country with regards to supporting the national COVID response plan.

Despite this challenging environment we also completed the first half of the year with a very sound performance that weathered that storm. And I will share a couple of highlights for now. So our top line was very resilient in the face of the pandemic. Our profitability has improved, underpinned by our sustainable cost management, very strong cash generation which moved us from negative free cash territory last year to positive. We strengthened our balance sheet and we saw a double digit earnings growth as well.

And maybe just to give a couple of highlights insofar as businesses are concerned, on the consumer side we saw massive mobile data usage growth and demand for connectivity despite the fact that the network rollout was slow based on the lockdown protocols and some of the distribution channels were closed. But also this then made us really look at how we strengthen some of the digital distribution channels as well almost as a semi-permanent factor going forward.

Total mobile performance was very strong, 19% growth in the subscriber base to about 13.7 million subscribers, ARPU increasing by about 37% to R113 on a blended basis, which is the highest in our history. Our prepaid base continues to grow, now in excess of 10 million subscribers. As a whole mobile gave us a service revenue growth of about 47%, which is very strong growth on a year on year basis. And the EBITDA doubled by approximately R1.8 billion to almost R3 billion. And our margin was expanded to 29.9%.

The big opportunity that we saw and that we were able to capitalise on is growth in data. We saw a 23% increase in the broadband base to about 9.6 million. And our total subscriber base now makes up more than 70% of the overall base. It's a very important milestone for us. We've always been focussed around data and how we make sure that we lead in data. Mobile data traffic grew with about 80%, which saw a revenue growth associated with that to about R6 billion. I'm also pleased that we've made substantive inroads in the data market over the past few years, which as I've indicated has been underpinned by our aggressive broadband growth strategy. We have now closed the data revenue gap in absolute terms between our Telkom Mobile and the number two player in the market. The gap is not big at all if you look at absolute data revenues. And we want to continue to focus on that over the short term so that we can truly become one of the leading companies in terms of data, especially in terms of revenue share in the data market.

Our objective is to broaden broadband adoption and yesterday we launched a content streaming partnership with the SABC to become the first official streaming video on demand service to host various SABC live channels and digital functionalities. We will be the first video and audio streaming platform that is aimed at the mass market consumer with a focus on local content in particular as we launched and focussing initially on the use but making sure that we are able to give them a value proposition on content that is not necessarily provided by other players in the market.

BCX has been negatively impacted by the COVID impact. There is a close coordination, as we've indicated before, between GDP growth cycles and BCX. With the lockdown and deep impact on the business almost all the large enterprises were under financial pressure. Retailers were closed. Banks were closed. The public sector was closed. And we saw how that impacted the performance of BCX. They could not trade during this time. They could not use some of our products. Some of them who before that had been great customers all of a sudden were not able to pay, so we had to partner with them to ensure that they are able to meet their obligations. In return they gave us 12 to 24 months of contract extension.

Some customers unfortunately closed down. Some went into business rescue. However, one of the things that we saw is that the costs were optimised almost as aggressively as the revenue declined. So, the BCX team did the best that they could to pull some of the levers on cost so that they can come in as flat as they possibly could. Their annuity revenue ratio they are maintaining at about 73%. As the economy opens up we want to see how that plays itself out. They are still continuing to pull the cost lever and looking to capitalise as the economy opens up in terms of new revenue.

Openserve, a big growth in fixed traffic demand, a 30% increase. And this was achieved with an overall broadband access connections reduction of about 16%. We saw a lot more people using. The average data usage per customer went up. We've been focused a lot on fibre to the home connections. We're now at a ratio of about 54%. This enables us to start remunerating the capital that we have deployed. And we have also started reducing our overall cost to connect fibre to the home by approximately 50%. This will enable us to really stretch the capex both to pass and connect homes. For us that's a very important measure so that we can start to remunerate our investment as quickly as we can.

Our drive to connect business customers to our Ethernet based network saw roughly a 50% increase in connections. We have grown fibre to the base stations by 10%. And despite all of this actually we still have that negative impact of enterprise fixed voice volumes declining. It is something that we have been managing as best as possible and we continue to do that. Gyro continued its performance with strong tenancy growth. As we indicated earlier on, we supported quite a lot of the operators, internal and external, to be able to deploy the temporary spectrum as quickly as possible. The revenue for the mast and towers business grew by about 7.7% with external revenue in that increasing by 10.5%. The number of leases has grown by about 11%. The EBITDA grew by about 27% with the margin growing from 65% to about 77%. So I will now hand over to Tsholo who will unpack the financial performance.

Tsholo Molefe

Thank you Sipho. Good afternoon everyone and good morning to everyone on the international side. I will just unpack the key financial messages. I think before I do that, it's important to highlight that the published prior period results were restated with the cost of third party services in BCX of R44 million. So, the current results are measured against those restated prior numbers, and the number is R44 million. Just to unpack a bit further, overall as indicated our top line really demonstrated resilience, down 0.4% to R21.4 billion year on year. Our revenue streams as you saw were impacted in different ways by the pandemic. Firstly, the mobile service revenue grew 47.8% largely underpinned by the data traffic growth of 80% that we saw as well as the subscriber growth of 19% to about 13.7 million subscribers, particularly with the increase in people working from home, online schooling as well as the ongoing investment in our mobile network.

Secondly, in the wake of this pandemic what we saw is enterprise customers really reducing or deferring their IT spend which resulted in roughly about a 16% decline in our IT revenues. We also had the migration to work from home negatively impacting the enterprise fixed business as fixed usage was then being diverted to mobile connectivity leading to a significant decline in fixed voice revenues of about 29.8%. We continued to commercialise our current mast and tower portfolio as Sipho indicated, and from an external revenue perspective we saw an increase of about 10.5% from the tower revenue to about R346 million.

Our continued focus on reducing cost is really bearing fruit as we protect our group EBITDA and margin despite a tough economic environment. We saw group EBITDA increasing by 6.3% to R5.9 billion and margin expanding by 1.7% to about 27.6%. We optimised both direct and operating cost with a decrease of about 5.3% on direct expenses and 1.5% on our operating cost. This was really a significant improvement particularly in terms of total cost to revenue ratio.

So, firstly, if I start with our direct expenses, the reduction in direct cost was largely driven also by the slowdown in the cost of handsets and equipment due to the lockdown impact on the distribution channels. This enabled mobile business to reduce its direct cost to revenue ratio from 56.2% in the same period last year to now about 38.2%. However, if we exclude the once-off of handsets and equipment savings from cost of sales, our cost to serve to mobile service revenue ratio – which is really a combination of payment to other operators as well as sales incentives and logistical costs – was optimised from 36% in the same period last year to now about 30.5%. This was in the main, as I indicated, due to payment to other operators reducing as we sought to manage our roaming costs down despite the significant growth that we saw in our mobile. I think also as the size of the business grows from a mobile perspective they are able to negotiate better commission rates with the dealers. So that assisted in terms of overall improving the cost to serve ratio to about 30.5%.

In terms of opex we reduced compared to the prior period. This was significantly better than our target of containing operating expenditure to below inflation. This was mainly underpinned by the benefit of phase one of the restructuring programme where in the first half we were able to realise benefits of about R440 million, and also some of the employee expenses that we continued to save on of about R93 million. However, this was partly offset by some of the employee benefits provisions, for example provision for leave pay and provision for incentives.

The group EBITDA performance was also supported by the reversal of a R66 million relating to the provision for bad debt, the COVID-19 impairment which we took at the end of the year. If you recall, at the end of the financial year 2020 we took an additional impairment of about R626 million. While we did not see any deterioration in the first quarter of the first half, we started seeing a deterioration in the second half. However, we also saw an increase in our debtors' book due to the increase in our mobile business. We had to increase our impairment on receivables, but really reserved as a result of no deterioration that we saw in the first quarter. So we will continue to be conservative in this approach, also anticipating that we may have the second wave of the pandemic coming through. So the bulk of our additional COVID-19 provision will be kept as a provision till the end of the financial year.

So, from an earnings growth perspective really robust earnings growth, double digit growth in terms of headline earnings per share as well as basic earnings per share, with HEPS at 25% increase to 219 cents while basic earnings per share increased by 29.5% to 217.5 cents. This was mainly driven by almost a 19% growth in operating profit as a result of our EBITDA growth as I indicated, but was partly offset by an increase in our effective tax rate from 29.9% to now 34.8%. We also saw strong cash generation during this period. Our adjusted free cash flow after adjusting for the VSP payment improved by R2.6 billion from negative R1.3 billion last year to now R1.3 billion positive. This was also really due to our ongoing efforts to release cash which led to an improvement in cash generated from operations of about 32.7%. If we then obviously exclude the payment that we made relating to phase one of the restructuring or the VSP payments of R1.1 billion we still saw cash generated from operations improving by about 12%.

Our free cash flow was also positively impacted by a slowdown in our capex rollout this year. As I indicated, the capex rollout was essentially also as a result of the national lockdown. We saw a 31% decline year on year. However, operating free cash flow before capex was still better at about 13% relative to last year. So in terms of free cash flow before VSP payments we saw obviously an increase from R1.4 billion to positive R200 million. We still expect to maintain in the second half of the year a positive free cash flow. We were able to strengthen our balance sheet, particularly as we looked at our funding approach under these conditions. We saw our cash balances improving from R1 billion same period last year to now about R3.9 billion. So even after paying the SARS payment of R350 million, after paying down debt of about R900 million, as well as paying the R1.1 billion we still were able to maintain healthy cash balances as I indicated of R3.9 billion.

In terms of our borrowings we were able to pay the R900 million, enabling us to reduce our borrowings by 6.2% year over year. And our net debt to EBITDA ratio improved firstly from 1.4x same period last year to about 1.3x at the end of the financial year in March, and now at 1x. And this is after taking to account the impact of IFRS 16. In terms of our net finance charges it declined by 6.8% largely underpinned by our strategy to switch from fixed to floating rate debt in the prior year. The average cost of debt also declined by 3.6%. So we really benefitted from the low interest rate environment due to the current economic climate.

In terms of looking at the outlook in conclusion, in the second half of the year we will continue to build financial resilience in the face of this tough economic environment, but focussing on the very same levers that we have been continuing with. Firstly, sustainable cost management programme, continuing to preserve cash, which is very important to us under these conditions, disciplined capital allocation, as well as mitigating refinancing risk on our balance sheet. We will continue with the sustainable cost management programme as a lever to be able to protect group EBITDA as well as margins. We expect the remaining benefit of phase 1 of the restructuring programme that we realised in the first half of the year to also continue in the second half of the year. So the R443 million that we realised in the first half of the year will be repeated in the second half of the year as well.

And with regards to phase two of the restructuring programme we have BCX already in progress and we expect to conclude that by the end of the financial year. With regards to the corporate centre as well as the support functions in the business units, we are still in design phase and we expect to conclude that roughly sometime in the first half of the new financial year. The benefits of phase two of the restructuring will come through in the new financial year. So in terms of this year we are still on track to realise our targeted cost saving initiatives. If you look at some of those achievements that we've been able to make of between R1 billion to R2 billion, in the period under review we obviously realised about 50% of that. So we still believe that we are on track to conclude the balance of the target that we committed to.

As I indicated earlier, protecting our liquidity is of utmost importance to us under these current conditions. We remain comfortable with the annual cash release initiatives target that we gave at the end of the year of between R700 million to R1 billion to be able to continue to preserve cash. We've already started executing on handsets receivables financing, and so far we've realised R164 million, but this came through in October, which is the beginning of the second half of the year. We expect an additional R400 million to be concluded before the end of the financial year.

Through our improved cash generation as well as this positive cash flow due to optimised working capital we have been able to strengthen our balance sheet, really providing us with sufficient headroom to be able to fund the anticipated spectrum acquisition and other key investment requirements that we have in the business, and we are comfortable that we will be able to do this through a combination of cash and debt. We will not issue any shares to fund any spectrum. Our capex rollout, as I indicated, was impacted by the national lockdown in the first half of the year. However, we do expect that we will get back to the schedule in the second half with ranges probably at the same range as the previous financial year.

With the highest connectivity rate that we have seen in terms of fibre to the homes passed of 54% and a significant reduction that Sipho alluded to in terms of unit cost to deploy, we will obviously want to accelerate our fibre rollout programme with the objective of making more homes fibre ready while we continue to drive higher connectivity rates as we have been doing. We will also continue to invest in our mobile business to support the mobile growth. So, we are comfortable that with all the efforts that we are making really being able to strengthen our balance sheet, strong cash generation, we will be obviously thoughtful with our capex level and make sure that as the revenues come through we maintain it to the acceptable levels. And we should be able to emerge with a positive free cash flow. Really that is the outlook for the second half of the year, and I will therefore now hand over to Sipho to conclude.

Sipho Maseko

Thank you very much Tsholo. I'll just touch on two things as we conclude. Firstly, the regulatory environment. If you recall there was the temporary assignment of spectrum which was assigned up till the end of November that was subsequently extended to the end of March next year. The ITA also was released, which is a significant step in the development of the ICT sector in South Africa. Much as we are pleased that ICASA has excluded 2300 band from the auction, it also prevents us with the opportunity as Telkom to acquire the much needed sub 1 GHz. We are however very disappointed in how ICASA has narrowly defined the market, which is likely to perpetuate the skewed market structure.

We've been beating this drum for the last couple of years that the market structure is skewed and it will be up to the policymakers in terms of what they want. If they want competition in the market it's best for them to do that in a way in which they can use spectrum as one of those levers that can facilitate greater competition in the market. I would probably rather have that if I were them than attempt to regulate prices. Price regulation does not in the end help anyone. It breeds inefficiency overall in the market. And in our reading of the ITA, and as I've indicated, the way in which ICASA has adopted spectrum it incorrectly regards spectrum equilibrium as the balance necessary to promote competition.

The ITA also disregards the implication of spectrum arrangements that exist between smaller players and larger players with regards to competition issues. All these issues in our view are fair for us to raise. This approach actually in a sense disregards the express findings of the Competition Commission that the market is duopolistic and the competition in it is not effective. We were simply touting the same path that the Competition Commission has gone through before. Lastly, there is the whole notion of awarding spectrum to the WOAN. As a player in the market we think if there is to be a WOAN you want to have it as viable. If you're going to allocate it spectrum that the ITA is proposing it will not be viable because it will not have the necessary scale to address barriers to entry, and more importantly the effective rollout of 5G in South Africa. We see this as a missed opportunity in time when the South African economy actually needs it.

With regards to unlocking value we remain committed to the value unlock strategy unlocking value from our portfolio of businesses is a key component of our capital allocation framework and will afford us as management the flexibility to rebase our balance sheet and invest prudently in the right growth portfolios. In the first half of the year we started with the market sounding process to gauge interest on the Gyro mast and towers business. And we have concluded that process and the analysis thereof, and now we will be proceeding with a firmer plan in the second half of the year. Secondly, we've made significant progress in structurally separating our fibre infrastructure business – that is Openserve – and we are in the process of concluding the separation of its balance sheet from Telkom. Once we've done this we will then be able to perform a further valuation of Openserve's key assets on real data, then prepare Openserve for its own value unlock opportunity.

We've also started to look at our data centre portfolio as we seek to expand further into a major infrastructure provider. We've explored the expansion of capacity for existing data centres including evaluating edge data centre possibilities within our portfolio, especially with 4G and 5G coming. So in a sense some of the big exchanges that we have will perform a key role as part of our edge data centre opportunity set. Therefore, considering the overall portfolio that we have, this supports our ability to roll out data centres at scale, collocation, vendor neutral, and truly position ourselves in this world of data explosion where we are able to have a sufficiently distributed portfolio of fibre assets to carry the traffic, of data centre assets that are located in the right way to be able to host applications, especially mission critical applications, and a tower portfolio which provides wireless connectivity as well. So I will pause there, Claudia, and maybe take questions which we will handle between Tsholo and myself.

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 your question, please press * then 2 to remove yourself from the list. Again, ladies and gentlemen, 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. Thanks for the opportunity to ask questions. I just wanted to check in with you on the rate of fixed voice decline and some of the data lines there. You mentioned on the data side in enterprise you could see an uptick in the second half. Should we expect the rates of decline to start to slow a bit, or is it still too early? And then in the earlier conference call I don't know if I was mistaken, but I thought I heard Tsholo say that mobile EBTIDA margins for the full year would be 20% to 25%. I'm just trying to understand first if that was actually given as guidance, and secondly, if it was, what's going to compress margins in the second half on mobile.

Sipho Maseko

Sure. Maybe Tsholo can take the questions first and then I'll build on them.

Tsholo Molefe

Thanks. If I can start with the last one perhaps, Jonathan, thank you. Yes, the mobile EBITDA currently was obviously boosted by COVID-19, particularly with regards to the savings on the cost of sales. So the 29% or 30% we don't see as sustainable. We think that a sustainable EBITDA margin is in the region of 20% to 25%. That is really in the range, and it will probably be more on the high end for the full year in terms of the EBITDA margin for the full year. So it will be more on the high end side of the 20% to 25%. So, there will definitely be a correction in the second half of the year largely due to us expecting to start seeing the post-paid growth or the cost of handset sales coming through in the second half of the year.

With regards to the enterprise market I think that it may still be early to tell. The first quarter of the first half was probably the worst for the enterprise business as we were in lockdown level 5 and 4. We do expect that as the economy opens up a bit we might see a slight improvement, but we think overall to expect a significant improvement it is still early to tell. As you know, that environment is highly GDP sensitive, and now accelerated by the COVID-19 impact. I think on the fixed side we've always said from an enterprise market perspective we expect firstly that to continue. It was accelerated to a large extent by COVID as well. As I indicated, most of the enterprise businesses moved from fixed usage to mobile connectivity. So that's the first thing. I think the second part is that this is in line with the changing technology that we have seen, obviously customers moving from traditional products to things such as voice over IP, but also moving from Diginet to Metro Ethernet. We have started seeing that growth coming through, but as we've indicated in the past, you need a lot more volumes to come through to be able to see that switch coming through in a meaningful way.

Jonathan Kennedy-Good
I wanted to ask one more question. Your prepaid APRU was quite spectacular in terms of its jump from March period year end despite adding significant amounts of subscribers. I just wanted to get a sense if that continued post period-end i.e. that R85 spend level.

Tsholo Molefe
We think it will rebase to 2020 levels. Part of it was because of everyone working from home using as much connectivity as possible. I think we always said that probably customers were prioritising connectivity above any of their expenses. So we had quite a bigger spend from consumers so to speak. We don't think that we will see the same trend, but it will not obviously be a lot lower. That's the message certainly from our consumer business.

Sipho Maseko
And maybe just to build on the points that Tsholo made, indeed I think we're being prudent around this as well, Jonathan. As people are probably getting better control and management of their data consumption we're then taking a downside view that this elevated pricing on prepaid will probably be managed down. So therefore that will create a bit of a challenge, and we really want to make sure that we keep the consumer team under the cosh in terms of them continuing to drive some of the initiatives that we've put in front of them. Insofar as the fixed voice decline, the imposition of the lockdown at the end of March was a massive shock in the system. All of a sudden what you had was something that was declining at 20%. Government offices were closed. Businesses were closed.

And for the first time actually there was a migration from making business calls to be on platforms like Teams and Zoom and all of those sorts of things with a concomitant growth in traffic. We've seen that growth on what we would call the new generation fixed data networks coming through very nicely, but it's still not large enough to offset the declines that you have seen on the voice side. I guess what I think we've been able to do is to de-risk our business fundamentally now. The mobile business is larger than the fixed business in simplistic terms, and our data focus is beginning to pay off, especially in terms of new generation, both on the wireless side and also on the fixed side. That's where the intensity of the focus is, on top of other cost optimisation initiatives that we need to be driving. Thank you.

Jonathan Kennedy-Good
Great. Thank you.

Operator
Thank you. The next question comes from Vikhyat Sharma from RMB Morgan Stanley. Please go ahead, Vikhyat.

Vikhyat Sharma
Hi guys. Thanks for the opportunity to ask questions. I've got two simple questions. Have you given any details on the phase two of restructuring, how big it is and how many employees are affected because of this, if there is an indication on that? The second thing is I think the two big players have been indicating that they are bringing down the pricing ladder because

of all these Competition Commission issues that have forced them to bring the prices down, so they are a lot more competitive. I just wanted to know how you look forward for your mobile growth in the environment these big two players are competitive? You've indicated that you want to take that prepaid pricing down further to still go for growth. I just want to know how the price dynamic is working especially in that mobile environment.

Tsholo Molefe
If I can start with the phase two restructuring, it will not be at the same levels as phase one. Phase one was almost R1.2 billion, almost 3,000 people. We are busy in BCX. We've already issued notice and it's probably roughly about 300 people, there or thereabout. As I indicated, on the head office side and the other support functions across other business units it's still early to tell. We're obviously thoughtful that we get the operating model correct, firstly from a corporate centre perspective and all the other support functions. So we are busy with the design and we should be able to provide more colour at the end of the year. But that will come through in the first half of the new financial year.

Sipho Maseko
So in terms of the price reductions from the bigger players we haven't seen the effect of that actually, Vikhyat. We haven't seen the effect of that. We are still growing subscribers. Our customers are spending a lot more with us. And I think I mentioned this before, and I will do so. We don't have the burden of 2G so we have freed up a lot of our spectrum to be able to carry a lot more traffic. We have shut down I think at the end of the period almost 70% or 80% of our 2G traffic. We had already switched that off, so that freed up quite a lot of the spectrum. And we have been very deliberate in making sure that as many of our towers as possible use fibre as backhaul so that we can be able to carry the outsized bundles of traffic that we've been able to offer to our customers. So that's on the wireless side. We see that growth in mobile. We see that growth in LTE.

And that is supplemented as well by the progress we are making on the fibre side with our homes connection ratio. We think that we have set the business for growth in data. Actually, if you look at the absolute data numbers between ourselves and the number two player, I think we are finishing the first half of the year at about R6 billion of revenues just on data, whilst our nearest competitor at number two finished at R7 billion. And that's a metric we are focussed on. How do we get to a point where in absolute terms we are equal or better with our nearest? And then from there without the albatross of 2G voice we think that we'll be able to seize the opportunity to further grow our position in data going forward, complemented obviously by what we do on the fixed side.

Vikhyat Sharma
Thank you so much. Thanks.

Operator
Thank you. The next question comes from Dilya Ibragimova from Citi. Please go ahead, Dilya.

Dilya Ibragimova
Hi. Thank you very much for the opportunity. I had a couple of questions please. The first is on the tribunal case. Maybe you could give us a bit more on what your expectations are, whether you would hope that this case has been given attention and potentially a conclusion before the auction takes place in March, or that would be something that you wouldn't necessarily expect to be resolved before then. My second question is on data centres. Could you give us a bit more colour as to what you plan to do? Is it something that you'd like to invest into more to perhaps add more capacity? I think in the morning you mentioned you have around 11% share of the market. Some colour there. And I'll stop here. Thanks.

Sipho Maseko
Sure. No problem. Maybe let me start with the second question. Insofar as data centres are concerned we have a fair distribution of data centre locations that has been used exclusively by BCX. So we will now begin to use them on a vendor neutral basis like our masts and towers. That business will be migrated into Gyro. So it will be another asset class that we will be looking to bringing third party investors as well into the business. BCX will be an anchor tenant in that business

model of collocation essentially. BCX will obviously continue to have their kit within the data centre and manage people's applications there, which is data centre management services. But the actual data centre management, the real estate management, will be within Gyro. I think it is more suited for that. And the plan obviously as part of the value unlock is to dutifully examine all opportunities of value unlock and be able to seek a path to value unlock, just as we will do as well with Openserve.

Insofar as the Competition Tribunal, obviously we have no control on the timelines. But we have served the papers. The other parties asked for an extension for them to file their replying affidavits, which we agreed to. No issues whatsoever. We don't think that it's a matter that will be just swept aside. The tribunal is independent from the commission. We think that they will have to look at these arrangements because they are very crucial in terms of how ICASA finalises the spectrum allocation. If they finalise them in a way that is asymmetrical and does not recognise those spectrum arrangements, we don't think that would be contributing to a fair and equitable, level playing field. Our view is that the Competition Tribunal once it pronounces it will obviously have to bind ICASA. ICASA is one of the respondents in the matter as well because we think that they should have found otherwise and they did not, and hence we've taken it to the tribunal as well.

Dilya Ibragimova
That's very helpful. Thank you.

Operator
Thank you. The next question comes from John Kim from UBS. Please go ahead, John.

John Kim
Hi everybody. I'm just hoping you can update us on the capex rollout. I know H1 was a bit light due to COVID. I'm interested to see if circa R8 billion is the right number for the next two to three years. Last time we chatted you were about 80% built out on your core network. If you can give us a sense of the quantum and relative focus for the next two years. And then a short follow-on question with respect to spectrum. I think you previously indicated a potential cost of roughly R3 billion to R5 billion. Is that a lump sum payment or is that more likely to be structured over the years? Thanks very much.

Tsholo Molefe
So on capex, John, as I indicated earlier we do expect to catch up in the second half, but the levels will still be maintained in line with the previous year. We are thoughtful obviously about capex as we see the revenue, as I indicated. If the revenues don't come through we taper down capex. We are able to prioritise capex in the right way, and particularly in areas where we see growth. It's important for us, as I indicated, that we continue with our trajectory of positive free cash flow. So at those levels that we project we will be positive free cash flow. We have not guided the market in terms of the outlook in terms of the next two years or so, but in the second half of the year we are comfortable that we will be able to maintain it at prior year levels.

John Kim
Should we think in terms of capital intensity ratio to sales?

Tsholo Molefe
Capex as a percentage of sales, that is correct.

Sipho Maseko
And remember the range was 16% to 20% and last year we concluded the year at about 18%. And we think that we will largely come out at about 18%. That metric is very important for us, John, because now that the mobile business is where it is, we are now using a different set of metrics to manage them, both in terms of profitability and cash generation and how they manage that. and the rest of the other businesses that are not meeting that with Tsholo's capital allocation framework we are very adamant that we don't want to breach that level, unless it is clear that it supports growth and we can be able to see that growth that is coming through.

So the teams are really under the cosh in terms of making sure that the capital management process, the project management and delivery processes are such that we don't accommodate any more slack in terms of how that capex is used. Hence we've been pushing a lot with homes connection ratio as well, challenging Openserve to also reduce the actual cost, the unit cost of either passing or connecting a home. They've reduced that by 50%, whether it's changing the design. In the past they would go for a platinum design where a bronze design would work. All of those sorts of things are contributing to what we call capital productivity, and then being able to allocate it to those areas where the ratio of connection will be a minimum of 50% so that we can start to remunerate it as fast as possible.

John Kim
Okay. Helpful. And on to the spectrum question please.

Sipho Maseko
Do you mind to repeat the spectrum question, John?

John Kim
Sure. I have roughly R3 billion to R5 billion for spectrum. You had spoken earlier about a mixture of cash and debt. Upfront or structured payment?

Tsholo Molefe
It will be through debt. As I indicated we are now at 1x in terms of net debt to EBITDA ratio. At the levels that have been indicated in the ITA we are comfortable that we should be able to fund it through debt, either debt or cash. So, a combination of debt and cash.

Operator
Thank you. The next question comes from Myuran Rajaratnam from MIBFA. Please go ahead, Myuran.

Myuran Rajaratnam
Hi guys. Can you hear me better?

Sipho Maseko
Much better.

Myuran Rajaratnam
I'm on a Telkom fixed line.

Sipho Maseko
Tell me about it, my friend.

Myuran Rajaratnam
My first question is about the Rain Vodacom deal. I can see that you are arguing with the tribunal that it looks like a merger. For somebody sitting on the outside like me it's public knowledge that Vodacom gets a higher priority on that network than even for example Rain's own retail customers. And it sounds like there are penalties to Rain if they don't bend over backwards to carry Vodacom's traffic with better service than Rain's own retail customers. I mean that sounds like a merger to me. Surely this should be questioned. How do you see this? What are the points of dispute that you have, to the extent that you can talk about it?

Sipho Maseko
We've raised a couple of things. One of the points that we've raised is that there is an effective control by Vodacom on the Rain spectrum. Therefore this qualifies to be a merger. I think actually if I'm not mistaken we delivered probably about 400

boxes to the Competition Tribunal of all sorts of information that was in support of our affidavit. We do know that they will have to respond. We are waiting for something that is likely to happen tomorrow which will then lead us to also then to force [?] a discovery of some of their agreements as well. But we actually think we are on the right wicket here in terms of that matter. I don't think MTN and Cell C are far from that, but we wanted to start with this one because we actually think that our chances of being heard by the tribunal are very high.

Myuran Rajaratnam
Great. The follow-up question I had was physical infrastructure sharing. Legally we've seen some cases where Telkom has been forced to allow more people into their ducts and things like that, which is fine for competition. But infrastructure sharing should be fair and symmetric in its totality. So in some sense when you want to access their masts and towers, the bigger operators, I get the sense there is a financial incentive for them to take their time about it. And I know you've been beating the drum on this. Even at the recent enquiry you guys talked about it. What sort of avenues for correcting this are available do you think? How do we overcome this?

Sipho Maseko
So I guess the trouble here with regards to the approach that has been taken by some of our competitors in terms of accessing passive infrastructure is that it works if you have no passive infrastructure yourself. But it doesn't work when you have the sort of passive infrastructure that I'm maybe looking for. And certainly in terms of space on the various masts and towers of our competitors become fair game for us. We are thoughtful though because one of the things that I'm more interested in is to make sure that I can get to masts and towers where I can be able to pull fibre as quickly as possible in order to be able to drive a lower cost of production per bit. But as it were we want to see just how this is going to play out and how ICASA will play in the next couple of days and weeks because I would like to believe they are just on a bit of a back foot. Who knows? We'll see.

Myuran Rajaratnam
Great. Thank you.

Operator
Thank you. 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 Ziyad Joosub from Nedbank. Please go ahead, Ziyad.

Ziyad Joosub
Hi. Just two questions please. Sipho, on the data centre separation, is that something that Telkom will look to do independently or would you look to partner with a data centre operator in order to get your tenancies up or follow the vendor model? So would you sell us equity in that data centre post separation business? And number two, Openserve. Would all the fibre move with Openserve, every single kilometre of fibre when an eventual Openserve separation happens? Would we see the entire fibre footprint move across with Openserve? Thank you.

Sipho Maseko
Ziyad, you are asking me very tough questions. I'll start with the first one. On data centres certainly the theme here is value unlock, so we will curate them on a vendor neutral basis within Gyro, almost as we have done with masts and towers. They will be a distinct asset class within that business. And we will certainly be looking at partnerships or third party investors into data centres. We will start off with masts and towers as I've indicated. We've completed the market sounding process. We've met a whole variety of people that we've signed NDAs with. We have a clear sense as to how they would approach it but also how we would approach it. And as we are now starting the actual process we are very clear what that market looks like. And it's a varied market because it's made up of trade participants, it's made up of large pension funds and it's also the potential of whether you can go straight to the stock market. All of that is within our consideration table.

Insofar as Openserve is concerned, as we indicated earlier on we are finalising the structural separation and which are the assets that will move with Openserve. So what is clear for instance is the core network will move with Openserve, probably the aggregation network and the transport network. How do you then move the access network as well? Do you split the copper network away from the fibre network so that you can have what one might call "a clean new generation business" and then the rest remains elsewhere? So those are some of the considerations as we are doing the asset classification to make sure that we can achieve something that would be strategically sensible in the long term, but also enables us to manage the legacy in a way that doesn't hurt us and we can continue to milk it for as long as possible and without destruction of the team that manages the rest of the business.

Ziyad Joosub

Thank you Sipho.

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.

Sipho Maseko

Claudia, I think it's okay. I think we've pushed it as best as we could. The IR team remains available to take further questions. Babalwa and her team are always on standby, and we will be meeting some of the people over the next couple of days as well for deeper questions which they may want to ask at that point in time. Certainly we would like to thank everyone who participated in the call. Apologies that we started a couple of minutes late, and wishing you a good evening or a good day depending on where we are. Thank 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