Telkom SA SOC Ltd

Group Interim Results

for the six months ended 30 September 2020

Key highlights

Group EBITDA up 6.3% with EBITDA margin at **27.6%**

Group HEPS and BEPS up 25.4% and **29.5%** to **219.0** and **217.5 cents per share respectively**

Group adjusted FCF* improved by **R2 610 million** to **R1 343 million**

Mobile data revenue up 53.8% driven by **80.8%** growth in mobile traffic

Mobile EBITDA up 142.0% to **R2 900 million** with EBITDA margin at **29.9%**

FTTH connectivity rate at **53.8%**

The impact of the COVID-19 pandemic (COVID-19 or the pandemic) and the national lockdown dominated the first half of the year. The pandemic represents the largest economic shock the world economy has witnessed in decades, causing a collapse in global activity, with South Africa's gross domestic product declining by 16% in the second quarter of the year. Our group performance for the six months was sturdy in the face of an unprecedented pandemic where some of our corporate customers ceased operations and those who continued operating did so under severe financial pressure. As an essential service, we continued to enable connectivity through the lockdown and innovated to support "flattening the curve" and ensure that learning and teaching were accessible to all South Africans during this period. We weathered the COVID-19 storm and completed the first half of the year with improved profitability, strong liquidity and a strengthened balance sheet.

COVID-19

During the pandemic, organisations have a significant role to play in assisting government in its call to action to help "flatten the curve" and respond to the needs of communities. We took this responsibility very seriously and acted promptly by safeguarding the wellbeing of our employees by maintaining alert level 5 lockdown conditions within our operation for the protection of our employees. Telkom incurred R81 million in COVID-19 related expenses since the beginning of the national lockdown. Furthermore, we collaborated with the Department of Health and National Institute for Communicable Diseases (NICD) to develop the first track-and-trace application.

The impact of the pandemic has changed the world and we are now living through unprecedented times. We continue to invest in the long-term sustainability of education for learners. Telkom has zero-rated educational sites and launched Lightbulb, a comprehensive learning platform, to support learners on their educational journey, despite the disruption caused by COVID-19.

Performance overview

Telkom's business units were impacted in different ways by the pandemic in the first half of the year. The Consumer business benefited from the increased demand from people working from home, while BCX and SMB (known as Yep!) were negatively impacted by the national lockdown, as corporate customers were under severe financial pressure. Overall, group revenue demonstrated resilience in the face of the pandemic, down 0.4% to R21 396 million.

The Mobile business performed exceptionally well, despite the national lockdown negatively impacting distribution channels. The Mobile business sustained its growth trajectory into the first half of the year, growing service revenue by 47.8% to R8 282 million placing us solidly as the third largest mobile operator in South Africa. Our mobile broadband strategy continued to pay off and benefited from the increased data demand due to people working from home during the pandemic with mobile data revenue increasing by 53.8%. The ongoing investment in our mobile network and the temporary spectrum assignment enabled our Mobile business to support the 80.8% increase in broadband traffic.

BCX and SMB (known as Yep!) revenue declined compared to the prior period, negatively impacted by the national lockdown, as customers were under severe financial pressure. We saw customers requesting extended payment terms and applying for payment holidays to manage their liquidity. Migration to work from home negatively impacted the Enterprise fixed business, as usage was diverted to mobile connectivity, leading to a significant decline in fixed voice revenue. Enterprise customers reduced information technology (IT) spend in the first half of the year and postponed some of their capital investment projects as a response to the heightened uncertainty caused by COVID-19. This resulted in BCX IT business revenue declining by 8.6%.

Openserve saw an increase in demand for fixed connectivity resulting in an improved fibre to the home (FTTH) connectivity rate from 43.6% in the prior period to 53.8%, the highest connectivity rate in the market. The lockdown had a negative impact on Enterprise fixed voice volumes and impacted Openserve negatively. Consequently, Openserve's revenue declined by 13.6% compared to the prior period, driven by fixed voice revenue.

Gyro masts and towers continued to commercialise its current masts and towers portfolio in the period, with revenue increasing by 7.7% to R628 million despite the slowdown in the permitting and construction process due to the national lockdown.

Solid EBITDA growth underpinned by our sustainable cost management

Management relentlessly focused on its sustainable cost management programme to protect group EBITDA and margin. Group EBITDA increased by 6.3% to R5 908 million and EBITDA margin improved to 27.6%. Management optimised both direct costs and operating expenditure (opex), with decreases of 5.3% and 1.5% respectively, and with a significant improvement in total cost to revenue ratio compared to the prior period.

The reduction in direct costs was driven by a slowdown in the cost of handset and equipment due to the lockdown impact on distribution. This enabled the Mobile business to reduce its direct cost to revenue ratio from 52.6% in the prior period to 38.2% leading to a significant increase in Mobile's profitability. Excluding handsets and equipment, the cost to serve to mobile service revenue ratio was optimised from 36.3% in the prior period to 30.5%.

Opex reduced compared to the prior period, which is significantly better than management's target of containing opex growth below inflation. This was mainly underpinned by the benefits of the restructuring program of R443 million realised in the first half of the year, partly offset by employee benefit provisions.

The group EBITDA performance was also supported by the reversal of R66 million relating to the expected credit loss (ECL) COVID-19 impairment on receivables (provision) that was recognised at the 31 March 2020 financial year-end.

The group did not see a deterioration in its debtors book performance in the first quarter of the current financial year. However, in the last two months of the first half of the year, management started seeing a deterioration in the debtors book, although it was not to the extent that was anticipated when the provision was raised in the 31 March 2020 annual financial statements. Management remains conservative on provisioning relating to the ECL COVID-19 provision and only released R66 million at 30 September 2020. Management remains comfortable that the group continues to raise sufficient provisioning to cater for the depressed economy due to COVID-19.

On an underlying basis, excluding the once-off reversal of the provision of R66 million, group EBITDA increased by 5.1% to R5 842 million with the EBITDA margin at 27.3%.

HEPS growth driven by higher operating profit before tax

Headline earnings per share (HEPS) increased by 25.4% to 219.0 cents per share while basic earnings per share (BEPS) increased by 29.5% to 217.5 cents per share compared to the prior period. This was driven by a 18.8% growth in operating profit as a result of a 6.3% growth in group EBITDA. This was partially offset by an increase in the effective tax rate from 29.9% in the prior period to 34.8%.

Group capital investment impacted by lockdown

Capital investment of R2 942 million, with capex to revenue of 13.8% was impacted by the national lockdown. We remained focused on our strategy and more than 48% of the capital investment was in the Mobile business. Our Mobile investment sustained its good returns, with mobile service revenue increasing by 47.8%. Fibre capex is 33.6% lower than last year, mainly due to slowing down of homes passed to improve the connectivity rate. Our FTTH connectivity rate improved to 53.8%, which is the highest connectivity rate in the market.

Strong balance sheet to fund future growth

Our conservative funding approach enabled us to report healthy cash balances of R3 905 million at 30 September 2020. We strengthened our balance sheet by repaying maturing debt of R900 million. This resulted in our net debt to EBITDA ratio improving to 1.0 times from 1.3 times when compared to 31 March 2020.

Strong FCF generation

Adjusted FCF* improved by R2 610 million to R1 343 million (H1 FY2020: negative R1 267 million). This was positively impacted by a slowdown in capex rollout as a result of the national lockdown, ongoing working capital optimisation and the Mobile business generating positive FCF for the first time since establishment. The ongoing cash release initiatives led to 32.7% increase in cash generated from operations, excluding the payment relating to VSP and VERP.

FCF improved 114.8% from negative R1 429 million to R211 million in the period after paying R1 132 million relating to VSP and VERP.

Regulatory environment

Following the temporary assignment of emergency spectrum for the period up to 30 November 2020, the Independent Communications Authority of South Africa (ICASA) extended the validity period to coincide with the auctioning of the high demand spectrum which is envisaged to be completed by 31 March 2021.

The release of the Invitation to Apply (ITA) for spectrum is a significant step in the development of the ICT sector in South Africa. It is an opportunity for Telkom to acquire the much-needed sub 1GHz and we are pleased that ICASA has excluded the disputed 2300 MHz band.

We are however disappointed by ICASA's narrow definition of the market which is likely to entrench the skewed structure of the market and that the spectrum assigned to the wireless open access network is unlikely to drive effective rollout of 5G in South Africa.

Outlook

In the second half of the year, management will continue to build financial resilience in the face of a tough trading environment, focusing on a number of levers; sustainable cost management, cash preservation, disciplined capital allocation and mitigating financial risks.

The sustainable cost management programme will continue as a lever to protect group EBITDA and margin with continued focus on both direct and operational costs. We expect the remaining benefits of phase one of the restructuring programme to be realised in the second half of the year and phase two of the restructuring program is already in progress in BCX. We are on track to realise our targeted cost savings of R1 billion to R2 billion for the full year.

Protecting liquidity is of utmost importance to us under the current economic environment. Management remains comfortable with the annual cash release target of R700 million to R1 billion communicated at the end of the prior period to continue to preserve cash. Telkom executed an off-balance sheet disposal of handset receivable book amounting to approximately R170 million in October 2020, with an additional R400 million expected to be concluded before the end of the third quarter. Telkom will be exploring similar initiatives to unlock cash flow during the second half of the financial year.

Through our improved cash generation and positive FCF due to optimised working capital and continued cash release initiatives, we have been able to strengthen our balance sheet, providing us with sufficient headroom to fund spectrum acquisition through debt.

Our capex rollout was impacted by the national lockdown, we expect to be back on schedule in the second half of the year. With the highest connectivity rate of 53.8% in FTTH and a significant reduction in unit cost to deploy FTTH, Telkom will accelerate its fibre rollout programme with the objective to make homes fibre ready while continuing its drive for a higher connectivity rate. We will continue to invest in our Mobile business to support the mobile growth.

Management remains 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 management flexibility to re-base the balance sheet and invest in growth portfolios. In the first half of the year, we commenced with a market sounding exercise to gauge interest on Gyro masts and towers. We are in the process of concluding the analysis of proposals received. Significant work is underway to enable Telkom to perform a valuation of Openserve key assets and prepare Openserve for its value unlock opportunity. We are also reviewing the data centre portfolio, as we seek to expand into a major infrastructure provider.

Sello Moloko
Chairman

Sipho Maseko
Group Chief Executive Officer

Tsholofelo Molefe
Group Chief Financial Officer

10 November 2020

Financial information summary	September 2020 R'million	Restated September 2019 R'million	Variance %
Gross operating revenue	21 396	21 479	(0.4)
EBITDA	5 908	5 560	6.3
EBITDA margin (%)	27.6	25.9	1.7
Capex	2 942	4 238	(30.6)
Adjusted FCF	1 343	(1 267)	206.0
BEPS (cents)	217.5	168.0	29.5
HEPS (cents)	219.0	174.6	25.4
Net debt to EBITDA (times)	1.0	1.4	0.4
Interim dividend (cents)	–	71.5	–

Further information: The short-form interim financial results announcement is the responsibility of the board of directors of Telkom. It is only a summary of the information contained in the long-form interim financial results announcement and does not contain full or complete details.

Any investment decisions should be based on the long-form interim financial results announcement published on the JSE's website on Tuesday, 10 November 2020 and also available on Telkom's website at **www.telkom.co.za/ir**.

The long-form interim financial results announcement, including the auditor's review opinion, is available on the company's website at: https://www.telkom.co.za/ir/financial/financial-results-2021.shtml and on the JSE's website at: https://senspdf.jse.co.za/documents/2020/jse/isse/TKG/ie2020.pdf

*Excluding the once-off VSP and VERP costs of R1 132 million.