

Conference call transcript

10 June 2024

Q1 FY2024 TRADING UPDATE

Operator

Good day, ladies and gentlemen, and welcome to Telkom's Q1 of FY2024 trading update for the quarter ended 30 June 2023. All attendees will be in listen only mode. There will be an opportunity to ask questions when prompted. If you need assistance during the call, please signal an operator pressing * and then 0. Please note that this event is being recorded. I would now like to hand the conference over to Serame Taukobong. Please go ahead, sir.

Serame Taukobong

Thank you kindly. Greetings to all. On the call is our group CFO, Dirk Reyneke, and the invest relations team, and we should also have the CFO of Consumer, Hasnain Motlekar. This morning we published our trading update for the first quarter of the financial year. I'm assuming that you've gone through it in detail, and I will touch on the key aspects of it to allow more time for questions. We'll be unpacking the trading update for the quarter as follows.

I will begin with the business performance for the prevailing quarter. Dirk will touch on the revenue and EBITDA performance for the group, as well as per BU. I will come back and give an update on corporate action, regulatory matters, and SIU judgment. I will also conclude on the commercial agreements that we are pursuing to advance the connectivity in South Africa.

We started the new financial year with good momentum as group performance was pleasing in the face of load shedding, muted economic growth, continuing inflationary pressures and consumers and intensively competitive landscape. Our performance continues to be impacted by legacy and fixed line revenue decline caused by ongoing migration to NGN technologies across our business as anticipated.

Cost savings from our recent labour restructuring process offset the impact of load shedding, but the legacy revenue declines along with higher ECL provisions weighed down on our overall group profitability. I will now take you through the performance of each of the business units.

In the consumer team, mobile service revenue grows driven by Telkom Consumer performance. Telkom Consumer recorded an increase in revenue with a growth largely attributed to the mobile business and the expansion of fibre offerings. Consumer fibre subscriber base increased by 12.8%, while legacy copper-based revenues continued the downward trajectory and now only account for 4.8% of the gross revenue. Mobile revenue advanced mid-single digits, primarily driven by continued provision of value-compelling propositions, which stimulated data consumption.

The biggest contributor to the mobile revenue growth was mobile service revenue, which also grew by 6.5%. Mobile growth was strengthened by year-on-year subscriber growth of 6.9%, bringing the total subscribers to 18.5 million with a blended ARPU of R83. The post-paid ARPU of R183 was derived off a subscriber base growth of 6.6%, translating to almost 3 million subscribers.

The prepaid output of R63 remains within our targeted range price, and the prepaid subscribers grew by 6.9% to 15.5 million. Mobile data traffic increased by 25.1% and amounted to 329 petabytes. This growth was bolstered by an 8.9% increase in mobile broadband subscribers to 11.7 million, which now comprises of 63.2% of total subscribers. We continue seeing robust growth in our non-connectivity services, with revenue increasing by 20%, with a significant contributor of this being our airtime advanced product.

If I look at Openserve, the Openserve overall revenue declined by low single digits, as the accelerated decline in fixed voice revenue continued as expected. Fixed line NGN revenue increased by 10.6%, underpinned by growth in broadband, carrier services, and enterprise services, which increased 21.5%, 6.3%, and 3.3% respectively. The NGN portfolio now comprises 73.7% of total revenue. The continued increase in demand for connectivity and consumption reflected on the fixed line data traffic increase of 13.3% to 512 petabytes.

Openserve's Connect-Led strategy, coupled with the smart deployment of our fibre infrastructure, enabled growth in its fibre connectivity based by 9.9% connections, which includes broadband and other value-added services such as VoIP, intercom, and security. The homes pass grew by 24.4% to 1.1 million homes, with Openserve surpassing the half mark of the number of homes connected with fibre, rising it by 24.2% to 515,000 homes connected, while maintaining the leading connectivity rate of 46.5%. Despite the sustained load shedding levels, Openserve continues to be able to maintain its core network at an availability of 99.9%. The deployment of battery primary backup solutions yielded a cost avoidance of more than R27 million in diesel costs.

Looking at BCX, BCX recorded low single digit revenue growth, mainly driven by the double digit growth of the IT business. The IT revenue growth was attributable to the software and hardware business, which continues to show excellent performance due to the fulfilling of order backlogs and the easing off of the global chip shortage, as well as successful new business deployment initiatives. The business also benefited from a strength in cloud offerings and solutions, brought about by Dotcom acquisition, whereas IT services declined by 3.4%.

Swiftnet recorded marginal revenue growth. The revenue growth was underpinned by escalations, new tenancies, customer 5G rollouts, and existing tenant upgrades. Revenue from other customers increased by 11% while a reduction in revenue from termination by MNO and Openserve decommission declined by 20.6%. Following the successful Power as a Service

testing in the prior financial year, Swiftnet is nearing implementation of the first phase of this rollout. I will now hand over to Dirk to talk you through the revenue and EBITDA performance on a group and BU level. Dirk over to you.

Dirk Reyneke

Thank you, Serame, and good afternoon everybody. Good morning to those in the US. If we look at the impact of what Serame has just covered on revenue and EBITDA, group revenue grew by 3.8% percent to R10.7 billion, mainly driven by the satisfactory growth in the new generation technologies. Having said that, Group EBITDA rate of decline decelerated, decreasing by 4.2% to R2.2 billion, with the EBITDA margin contracting by 1.7 percentage points to 21%, mostly affected by legacy revenue decline, together with higher direct costs and operating costs.

The benefit emanating from the staff restructuring was partly negated by additional spend in diesel due to load shedding still in the quarter, and then a slight increase in direct costs as a result of product mix. We also witnessed an increase in impairment of receivables and specifically the provision for impairment and increased ECLs in our BCX business and our mobile segments.

If we unpack the revenue per business unit, Telkom Consumer saw a 1.8% increase in revenue to R6.4 billion, driven largely by mobile revenue advanced by 5.2% reaching R5.4 billion, with a significant contribution to this growth coming from mobile service revenue which increased 6.5% to R4.6 billions. The surge in mobile data traffic that was bolstered by an increase in mobile broadband subscribers resulted in the mobile data revenue increasing by 9.9%.

Revenue in Openserve declined marginally, 2.7% to R3.1 billion, as the revenue growth from NGN was offset by a 29% decline in fixed voice legacy revenue. BCX saw revenue rise by 2.9% to R3.5 billion. The IT business revenue increased by 17.5% to R2.1 billion due to hardware and software business growing by 62.9%. Converged communications revenue declined by 12.8% to R1.4 billion as they are reaching the back end of the legacy decline. Revenue from Swiftnet increased marginally 1.2% up to R326 million with revenue from other customers increasing by 11% to R249 million.

If we then look at the EBITDA of the various business units, Telkom Consumer EBITDA increased by 10.8% to reach R931 million of solid revenue growth and a prudent cost containment resolve. The mobile EBITDA however declined by 5.6% to R1.1 billion, marking the end of double digit declines attributable to an increase in provisioning for bad debts as consumers continued to take strain and the ECLs increased in line with the growth of accounts receivable. Load shedding costs amounting to R54 million also impacted mobile's profitability.

In Openserve, the EBITDA was impacted by an increase of R88 million in diesel spent resulting in EBITDA margin of 28%, a reduction of 1.9 percentage points with EBITDA declining to R876 million. BCX EBITDA declined by 38.2% to R275 million as overall profitability continues to unfavourably be impacted by revenue product mix which was skewed to up towards lower margin product business for the quarter as well as significantly higher impairments of receivables plus slow collections particularly in the public sector.

This was partially offset by cost savings, largely in employee expenses and third party cost as the BCX continues to drive efficiencies. Swiftnet EBITDA increased by 1.7% to R234 million in line with the marginal revenue growth, and the EBITDA

in Swiftnet remains strong at 71.8%, translating to a 0.4 percentage point improvement. Serame will now take you through an update on corporate actions to realise value, regulatory matters, the SIU judgment and the structure of the commercial collaboration with Broadband Infraco as well as Sentech. Thanks, Serame.

Serame Taukobong

Thank you, Dirk. So just on the commercial actions to realise value, we have received offers to acquire Swiftnet in its entirety during the last quarter of F23. We are currently engaged in discussions with two bidders for the disposal of 100% of Swiftnet, and we hope to be making these announcements shortly. We have been encouraged by the incredible interest shown in Openserve, following our market sounding exercise earlier this year. As we position ourselves as an infrastructure business at its core, and once this transition has been concluded, Telkom will consider its further options to realise value, including in relation to the expressions of interest received for Openserve. We are also continuing investigating the introduction of a strategic equity partner for BCX to enhance scale, growth, and capabilities in various growth areas, including cloud services, cybersecurity, healthcare. Work on this is ongoing.

In terms of the regulatory matters, the Minister of Communication and Digital Technology has confirmed that the final analogue television switch-off date in the frequency bands above 694 MHz is 31 July 2023. If this is successfully implemented, the Sub-1 gig spectrum obtained in the auction in March 2022 will become available nationally from 1 August 2023. The outstanding R1 billion then that is for the payment of that spectrum will have to be settled.

We are also equally preparing comprehensive a response to the Electronic Communication Amendment Bill, which deals with several critical issues such as spectrum trading and sharing, roaming, MPNOs, passive infrastructure, and facilities access and competition. In terms of the SIU judgment, the High Court handed down a judgment, setting aside the proclamation that gave the Special Investigation Unit, the SIU, authority to investigate various matters including Telkom's contracting for network and advisory services at the disposal of former Telkom facilities. The proclamation was declared unconstitutional, invalid, and of no force or effect, and the respondents were ordered to pay Telkom's legal costs.

We also want to set clarity on the media issues that talk to the Broadband Infraco and Sentech collaborations. What I need to state clearly to the audience is that these are based purely on commercial agreements. They'll be predicated on commercial agreements, where we will utilise our current asset base like fibre and data centres, to offer our services to these entities. We actually do have commercial agreements with these entities.

These agreements will benefit the goals of both entities in advancing connectivity in the country. We will also support to advanced government policy objectives together with the achievement of our own corporate ambitions. These partnerships will not require any capital injection, nor are there any discussions of any merger with these parties. I'd like to state again, these are collaborations based on sound commercial principles. We've come to the conclusion of the call. I'll now hand over to the operator for Q&A. Thank you.

Operator

Thank you very much, sir. Ladies and gentlemen, as we are going to be conducting the question and answer session, if you would like to ask a question, please press * and then 1 on your telephone keypad or the keypad on your screen. A

confirmation tone will indicate that your line is in the question queue. You may press * 2 to exit the question queue. Just a reminder, if you'd like to ask a question, you're welcome to press * and then 1. Our first question comes from Madi Singh of HSBC.

Madhvendra Singh

Yes, hi. Thank you. So, just two quick questions. First question is on the co-production plans. So, I think the previous target was to announce why there's a bit of delay in announcing the winners for the Swiftnet side of things. And then secondly, on BCX, you are saying that you will explore options around that as well. So, would you consider exiting it completely as well, or at this point you are only thinking about a minority stake? Thank you.

Serame Taukobong

Thank you, Madi. I think with the towers transaction, we are in the last throes. And as one appreciates this process, part of the delay has been bidders requesting extensions to do more detailed evaluation of these entities, which we feel is important and prudent to do. So, we have given debaters extensions because it's quite a massive portfolio for them to evaluate. But we feel quite confident that we are close to that.

In BCX, the process has started, as I've indicated. We would obviously be shaped by what type of partnerships come through. We are open to even a point where Telkom has a minority stake in that entity if it gives us the right scale and capability. But it's early times for that. I hope I've covered you there, Madi.

Madhvendra Singh

Yes, thank you very much. And a very quick question on the operational performance as well. On the legacy fixed business, in your view, how many more periods do you think before the impact of the decline in this segment would be very minimum for the group performance?

Serame Taukobong

So, Madi, it differs by the various segments. So, I would say overall, between 18 and 24 months. Some entities have exited much faster. So, if you see, for instance, BCX is coming out. As I highlighted in Consumer, it now only accounts for 4.8% of their revenue. So, I would say, if I average across the entire group, between 18 to 24 months. Some BUs will drop off sooner in that period, that same line that I've given you.

Madhvendra Singh

That sounds very interesting. Thank you very much, Serame.

Serame Taukobong

Thank you, Madi.

Operator

Thank you. The next question comes from Nadim Mohamed of SBG Securities.

Nadim Mohamed

Good afternoon, Serame, Dirk and team. Just three quick ones from my side if I may. Just firstly on mobile data, we saw that traffic was up to 5% year-on-year and revenue was also up about 10% year-on-year. And what are the differences between prepaid and post-paid? And are you seeing more demand or consumption during load shedding?

Then secondly, just on airtime advance, I see that it's increased to 33% of recharges. I just would like to understand how quickly that has scaled up over the last year and what kind of default rates you're seeing there.

And lastly, I'm intrigued by the concept of positioning Telkom as an InfraCo at its core. I'd just like to understand what exactly you mean by that in terms of your strategic direction. Does it mean things like prioritising open access, long-term contracts with a lower risk profile? I would just like to understand exactly what the long-term vision is there. Thank you.

Serame Taukobong

Thank you, Nadim. So, it's actually four, not three. But I'll tell you what. I'll start with the last one. So, when we talk of an InfraCo, Nadim, we say, okay, when we sat down and did our strat session, we said, okay, who are we? What actually lies in Telkom? And what is our core strength? So, our core strength has been infrastructure, underpinned by 170,000 kilometres of fibre. If we take that a step further, you then have 10 data centres, of which three of them are Cat 4. So, that's the strength that we've built as Telkom over the past.

And it's for us to say, how do we focus on that? Now, somebody might ask the question. You say, okay, but then why would you sell towers? Once again, it's about saying, where can we lead and be successful? We've got 2,900 commercially active towers. The tower market is 221,000. You are not going to lead in that. If we have to split a Rand of capex, where is our best bet? Our best bet certainly sits in the InfraCo.

Now, when you look at the mobile business in that InfraCo, it means that once you start connecting the homes, you then start offering your fixed mobile conversions, where you can actually not just come in with data but you can come in with data and offer customers three or four mobile services with that. So, that's how we look at the InfraCo. In terms of the mobile data and the prepaid and post-paid growth and airtime allowance, I have invited Hasnain into the call. Maybe, Hasnain, you want to shed some colour there. Nadim, you know Hasnain, right?

Nadim Mohamed

Yes.

Hasnain Motlekar

Afternoon, everybody. Thanks, Serame. Just to clarify the question around prepaid, post-paid, the growth has been equally spread across the two. One hasn't over-indexed over the other. Obviously, subscriber volumes on the prepaid, just pushing more data volumes through that segment. But as a percentage growth, it's roughly the same. In terms of load shedding, so obviously load shedding is spread across the country at different times. But when you look at it cumulatively over a month, we've not seen actually data consumption gone down. We've seen slight increases as the load shedding kicks in, but then it normalises once load shedding is gone within a particular area.

But if you look at it across nationally and across a sustained period of about 30 days, we've not seen data consumption go down. In fact, we've seen it actually going up within the footprint we currently have. So, there hasn't really been an impact. Obviously, we've introduced more value compelling proposition from a data perspective, which pushed us through. But it's not impacted us significantly apart from the upside on the network. So, the question will be asked, if once load shedding subsides, can we see even more throughput on the network. And time will tell basically once we stay sustainably below stage four. Well, above four begins hard to keep the availability up. But if you stay sustainably below four, we should see data consumption continue to grow as well.

In terms of the second question around airtime, so airtime advances now account for about 30% of our prepaid business. We're comfortable from a risk management perspective, even though we have contracted for the risk, that we don't carry the risk around default. The defaults have been actually quite low, it's pleasingly low, where we can actually manage the default. We've not seen big black holes, and that was always the concern once you step into this line of business.

But the customer behaviours indicated actually a good predication to actually settle almost immediately, within the timeframes we forecasted. So, 30% is probably where we're at, where we're comfortable. We might stretch it maybe another 5%, 10%. But we'll be very conservative around this airtime lending business because it has the potential to go wrong very quickly. But the way we've managed to date is very conservative and it's grown actually very nicely for us.

Serame Taukobong

I hope that answers, Nadim.

Nadim Mohamed

Excellent. Thank you so much, I appreciate that.

Operator

Thank you. Ladies and gentlemen, just a reminder, if you'd like to ask a question, you're welcome to press * and then 1 to place yourself in the question queue. The next question comes from Nomandla Duma of PSG Asset Management.

Nomandla Duma

Hi guys. Dirk, can you please indicate the total cost savings that Telkom basically got from the restructuring? It's just not clear from the numbers.

Dirk Reyneke

Yeah, the Nomandla, the cost saving from the numbers, I think I said at year end. Total cost saving estimated at roughly R1 billion per annum on an annualised basis. In the first quarter people only started exiting towards the end of the quarter. So, we only started seeing the benefits towards the end of this quarter. So, I wouldn't call it significant. We won't even have the full annualised benefit of R1 billion for the full year. So yeah, I can probably look at the number, but the number will not be significant for quarter one. It will only really start coming through quarters two to four with full annualised benefits in

2025. Although we provided for the cost in March 2023, remember people only exited most of them towards May, June this year.

Nomandla Duma

Thanks, Dirk. And if I may, just on the Openserve numbers, it's almost a one-to-one decline if you look at the top line to the EBITDA. How are you guys managing that? Just looking at how incredible the next generation sales grew, but it looks like the EBITDA is actually under pressure. Can you get a bit of guidance on what's the strategy for Openserve?

Dirk Reyneke

I think if you look at Openserve, what's important is the margin. You're right that the decline in revenue EBITDA is almost one to one. Remember that's where bulk of the legacy sits. I think Openserve inclusive of the legacy decline is maintaining their margin. I think they went from 29% to 28% quarter on quarter. But if you compare it to Q4 of last year, they've improved their margins. And they've improved their margins on the back of cost savings.

So, twofold in Openserve. Their legacy revenue decline will still for at least the first three quarters be more than the NGN revenue growth. But because of efficiencies and cost savings, we do believe that their margin will start picking up from probably quarter three. But for the full year, their EBITDA in absolute numbers should start picking up more than the 1% that you've just seen. And then for us, if their margins are getting back to the 29% and 30% where they were, we believe that is a good business with annuity revenue at margins of 30%.

So that's a long way to say the strategy there is simple. It's still driving the growth in NGN revenue on all three levels. In other words, your backhaul fibre, your fibre to the business as well as your fibre to the home. Linked to that is your cost efficiencies to make sure your margin comes back into line and specifically with cost focus on which cost can be saved and taken out as you migrate off your legacy systems.

Nomandla Duma

Cool, that's great.

Serame Taukobong

Nomandla, remember that this is something that we are actively and aggressively managing to migrate to NGN, both on the BCX side and the Consumer side, and it's a continued access. That's the [unclear] migration that we're talking of.

Nomandla Duma

And if I may ask the last question to Serame specifically, thanks so much for the clarification on the partnership with the government. Just given the fact that they're related party transactions, will there be like transparency for the other shareholders just on whatever partnership that you're saying? Because you you're very upfront to tell us that it will be under commercial terms. Will there be clarity on that part if we look on your financials going forward?

Serame Taukobong

So, if you look at currently even with the current commercial agreements that we have, they all go through SETA in the government process. They all follow the same equal procurement process. What government has said is that where we can be commercially active to help execute government's ambition. So, there's no favours. There's no mergers. There's no Telkom merging with Infraco. No, none of that. It's commercial conversations on commercial terms.

So, a simple example. Government had intended to build data centres. We said to them, why are you building data centres when we've got data centres? You can come and lease space in our data centres at the same commercial agreements that everybody else gets charged on. So, that's the principle.

Dirk Reyneke

But I think, Nomandla, in terms of transparency, as Serame said, we've already got contracts with most of those entities and we're already doing business with them. And that business is disclosed on the annual financial statement as related party transactions. So, one could expect those numbers just to increase. But I think the transparency will have to be there. That's IFRS required and certainly we will comply with it.

Nomandla Duma

So, I guess from a financial perspective it's not additional deployment of capex. It's more monetizing Telkom's existing infrastructure base. Because I think that was what was unclear to us when we're actually reading the minister's articles. It wasn't clear if it potentially changes the guidance number for the capex that Dirk has guided for.

Dirk Reyneke

It will not it will not change the capex envelope. I think most of you got used to me talking about the capex envelope. So, it won't necessarily change the size of the capex envelope. It might influence which growth areas you do spend that capex on and you might reprioritise slightly. But as long as it makes commercial sense, whether it's existing coverage or planned coverage, it would have been part of our original capex plan in any case.

Serame Taukobong

So, maybe if I may, not to overindulge, I'll give you an example, Nomandla. I had a meeting this morning with the Premier of the Gauteng province. They have built fibre. They have their own fibre, but they have not been able to connect homes. So, he said to me, Serame, how can you help us connect homes and what are the commercial terms for us to connect those homes? So, in the homes that they've passed, it's obviously in our current capex plan. In the homes that are not in our capex plan, it will be a commercial agreement to say, we will help you connect these homes because you don't know how to connect homes. We know how to connect homes. Does that make it clear?

Nomandla Duma

Yes, that's very clear to me, Serame. And just on that, is there any possibility for Telkom to be challenged in this space? Are you the natural partner for government giving your extensive infrastructure base in South Africa? Or is it that it's possible that the other players actually come into the market and they offer the government better terms?

Serame Taukobong

If you look at how it's being done, a lot of the fibre, for instance, that government has deployed has been DFA. So, it's all governed under SETA. It's all on fair principles and absolute transparency.

Nomandla Duma

Thanks. That's fair to you guys. Thank you.

Operator

Thank you. Ladies and gentlemen, just a final reminder, if you'd like to ask a question, you're welcome to press * and then 1. The next question comes from Godwill Chahwahwa of Coronation Fund Managers.

Godwill Chahwahwa

Hi guys. Thanks for the opportunity to ask questions. A couple of questions from my side. The first one is on your network availability, just given what's been happening on load shedding. Could you give us some colour around where your network availability sits at the moment? And then just how that availability is impacted by your roaming arrangements? So, whether you are having to rely more or less on your roaming partners. And maybe threading that through to the impact on your roaming costs and your mobile margin.

And then the second question is around on the regulation side, the discussions around the mobile termination rates. If you could just give some colour in terms of your current position in terms of whether you benefit from this or not, and what your thoughts are on possible impacts if it goes onto that cost-based model which you speak about. Thanks.

Serame Taukobong

That's a good one. I mean, if you look at the network availability, it's actually on two sides. On Openserve, we've actually managed to keep our network availability to 99.9%. And that's been an ongoing investment in that core infrastructure because that's what runs the country. So, we have to make sure that we're there. On the mobile, obviously, because of the reliance on towers and batteries, etc., at various stages, if you go to a stage 6, for example, your network availability drops to just over 71%, which obviously has an impact because it's simply a numbers game.

Our position has 15,000 towers. Other guys have got, IHS 18,000 odd towers. Naturally, when one of our towers drops, they will have at least one of theirs over, and therefore we will see ourselves roaming higher on that. What we are doing is trying to make sure that, because we've got visibility of that, we can make sure that in those spaces that we're seeing the gaps, we can try and fill. It does increase your roaming costs marginally, but the roaming costs compared to the traffic that you see are not the same comparative. So, we're comfortable that the team is managing that perfectly.

In terms of CTR costs, I mean we are maintaining that. CTR has always been an interesting thing that the call termination rates is what actually grew the mobile industry. And that we feel that that stance is still quite important, especially given the conditions that we are under that the status of Telkom, Cell C, and the likes should be maintained. Because if you remove the asymmetry, the only benefit is going to be to the major players. And we doubt that they will actually translate that to customers. So, that's the stance that we've taken, Godwill.

Godwill Chahwahwa

Great. Thanks. Thanks, guys.

Operator

Godwill, does that conclude your questions?

Godwill Chahwahwa

Yes, that's all from me. Thank you.

Operator

Lovely. Thank you very much. It appears we have no further questions in the question queue. I will now hand over back for closing remarks.

Serame Taukobong

Thank you all for joining the call. I thought I might just wear my marketing hats and say thank you for all joining us for a call. As you all are aware, the 2023 Netball World Cup kicked off last Friday in Cape Town International Convention Centre with the South African netball team winning 61-50 in the first game and also winning in the second game.

Why do I say this? Telkom is an official premium partner of the Netball World Cup. We are committed to driving the development of netball in the country and have been a proud sponsor of the National Netball League, the first professional league actually created in the country formed by netball. So, I trust that you will all join us in supporting our national side. The marketing theme is that we stand tall with the Proteas and Telkom will continue to do things big for netball. Thank you very much.

Operator

Thank you, sir. Ladies and gentlemen, that concludes today's event. Thank you for joining us and you may now disconnect your lines.

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