



Telkom SA SOC Limited

Interim Results Presentation

for the six months ended
30 September 2019

Telkom

Operating environment

1

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Tough trading environment



Macro-economic environment

- Low GDP growth
- Consumers under pressure
- Enterprise customers deferring spend



Competitive environment

- Fixed voice revenue under pressure
- Pricing pressure in Enterprise
- Competitive mobile propositions



Regulatory environment

- Spectrum policy directive published
- Information Memorandum published for public comments
- Data market enquiry

Business performance

2

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Themes underlying performance



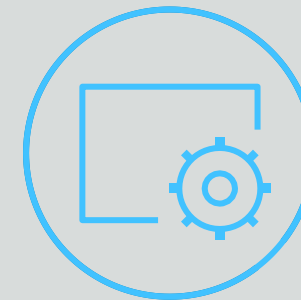
Capital investment

- Continued investment in key growth areas
- Investment in 4.5G technologies and fibre backhaul



Broadband leadership

- Highest home broadband customer base
- Highest FTTH connectivity rate
- Highest mobile backhaul ratio on fibre



Technology upgrade

- Upgrade from copper based to new technologies
- Higher customer retention on new technologies

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Consumer

Highlights

**75.7% growth in
mobile customers**

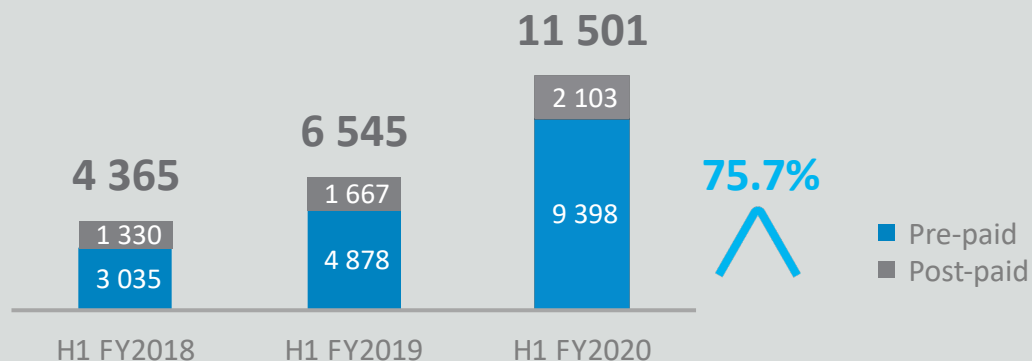
**2.0 million home
broadband customers
(highest in the history
of Telkom)**

**79% of our sites are on
fibre backhaul**

Mobile growth trajectory continues

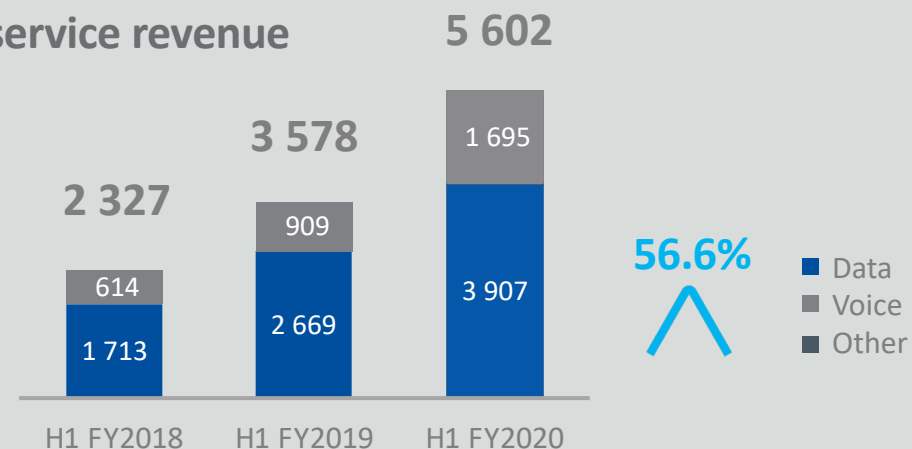
Subscriber growth

'000



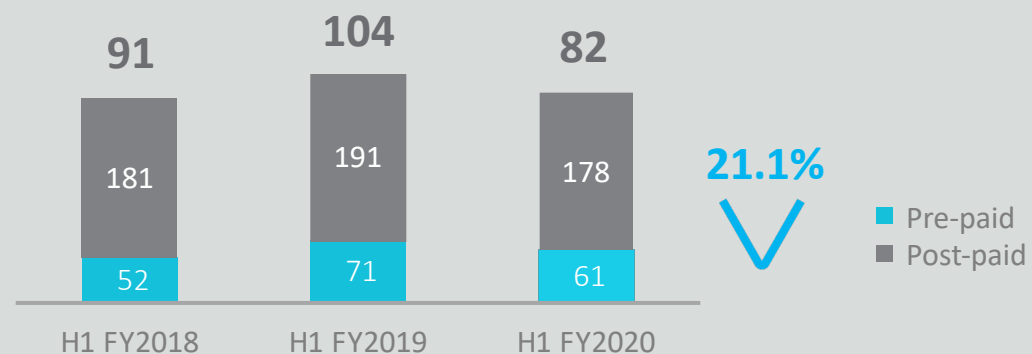
Mobile service revenue

R'm



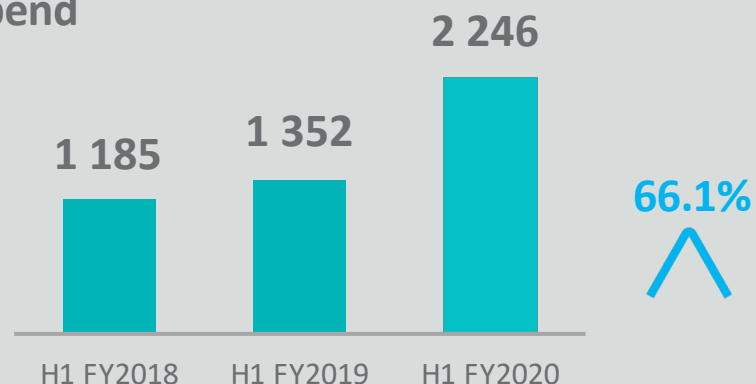
Blended ARPU

R



Capex spend

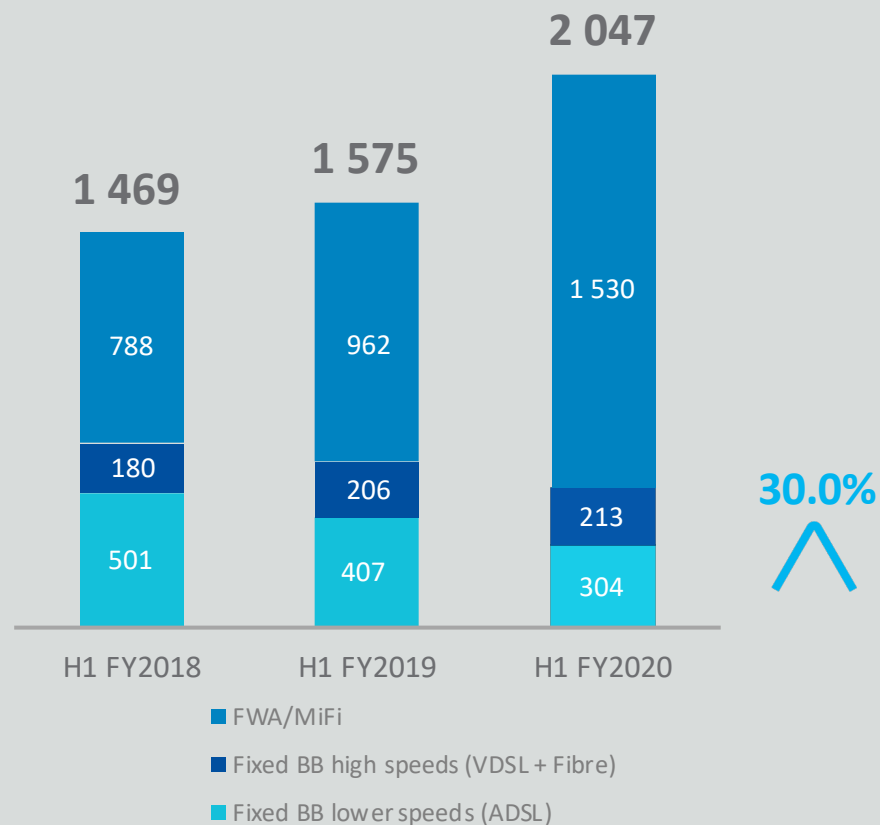
R'm



Accelerated high-speed broadband growth

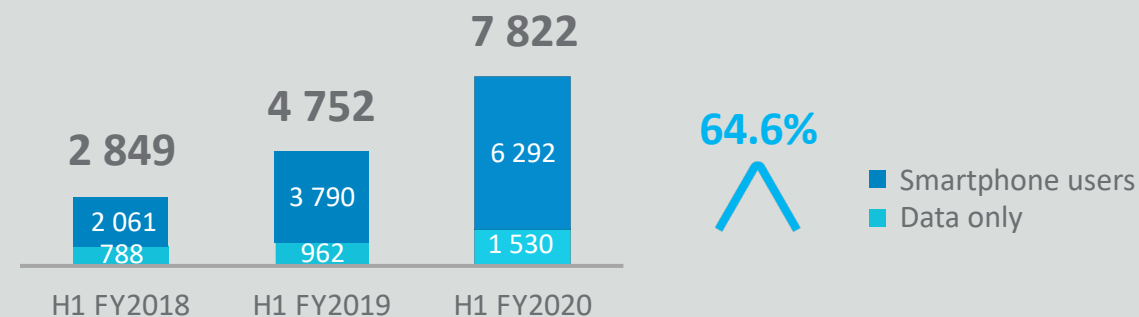
Consumer home broadband subscribers

'000



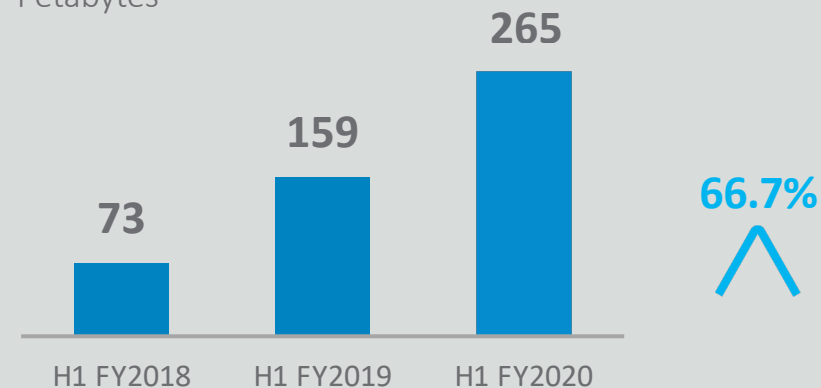
Mobile broadband subscribers

'000



Mobile broadband traffic

Petabytes



4.5G network underpins growth

Spectrum

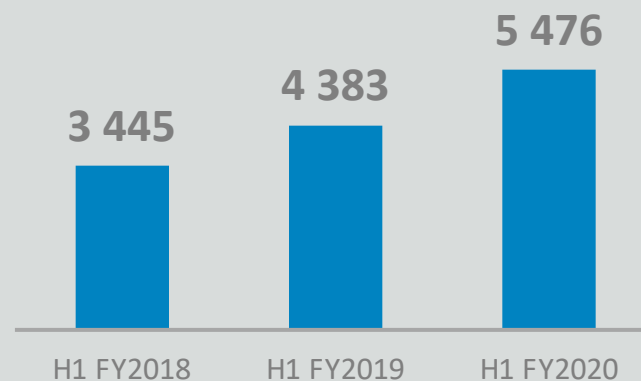
Spectrum	Telkom	MNO
2300Mhz	60Mhz	-
2100Mhz	30Mhz	30Mhz
1800Mhz	24Mhz	24Mhz
900Mhz	-	22Mhz
Total	114Mhz	76Mhz



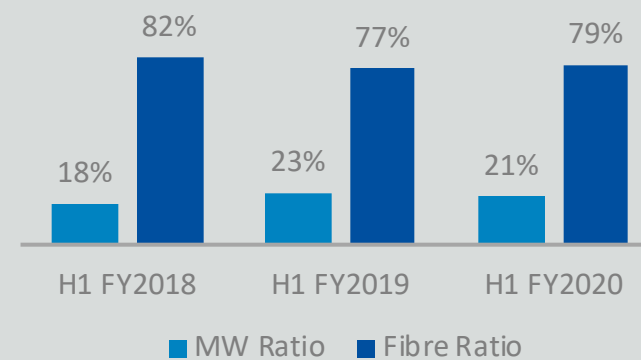
4.5G
LTE-Advanced

- Data centric mobile network
- Win in 4.5G Network
- Faster speeds
- Better user experience
- Efficient use of spectrum
- Additional spectrum 1.9Ghz & 3.5Ghz
- 2.3Ghz & 3.5Ghz possible assignment for 5G use

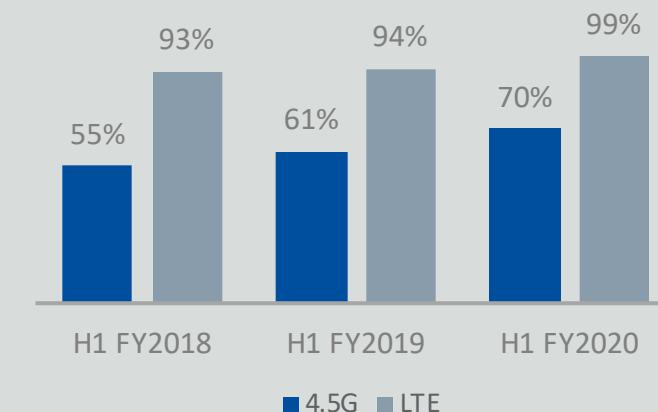
Mobile sites integrated



Site Backhaul



Site Type

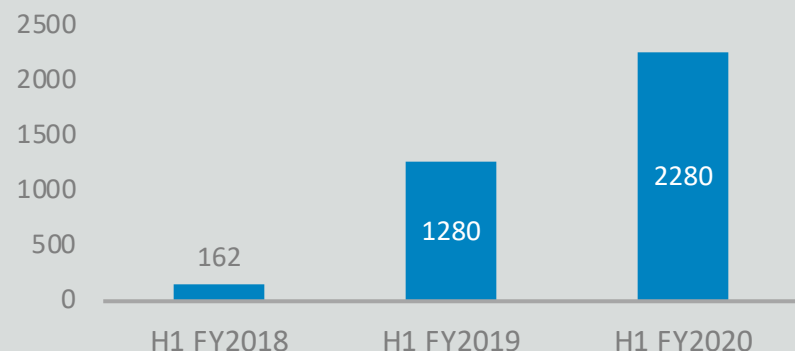


- Growing the 4.5G network footprint
- Highest LTE ratio in the market
- 79% sites backhauled by Fibre
- 4.5G evolution aligned to 5G roadmap
- Accelerated network expansion & investment

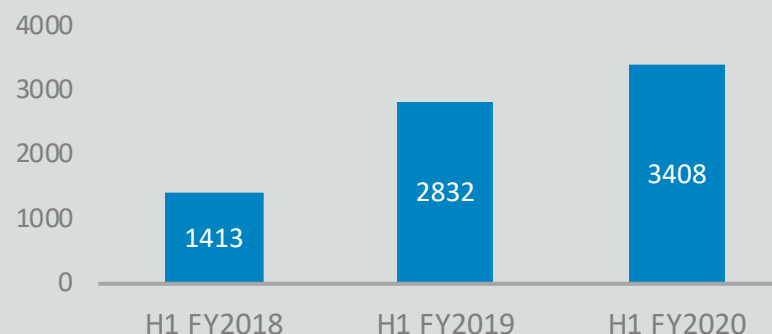
Capacity & coverage expansion

Network capacity

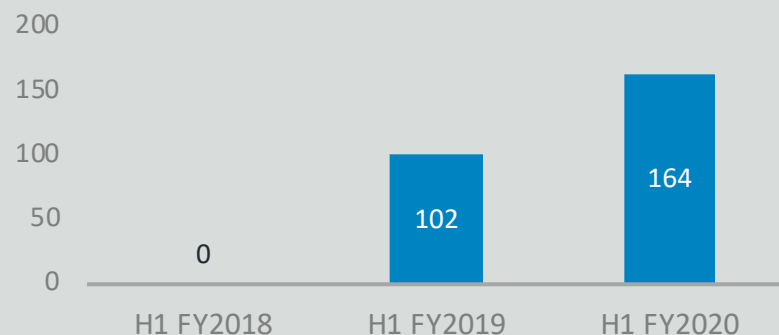
2100 Refarming



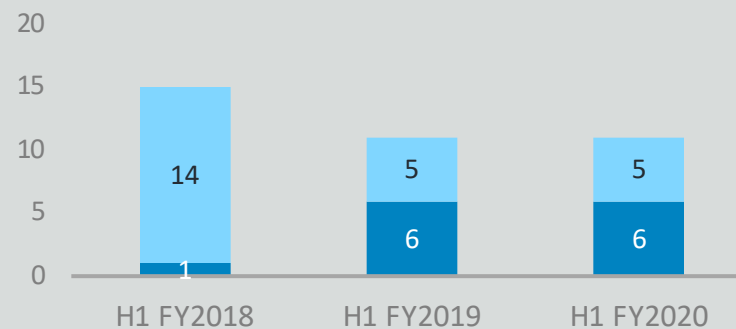
2CC & 3CC Upgrades



Massive MIMO Upgrades



Mobile Core Expansions & New Elements



■ Expansion ■ New

Mobile sites integrated

24.9%



5 476 sites





Highlights

**Strong EBITDA
growth up 22.6%
with a margin of
16.8%**

**IT revenue up 1% in
a weak economy**

**Portfolio review
concluded**

Successful execution



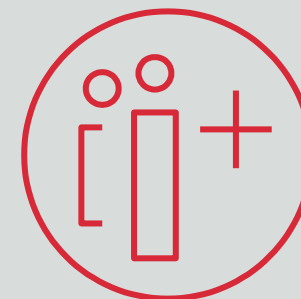
Improved profitability

- Organisation cost-to-serve reduced resulting in **22.6%** increase in EBITDA
- EBITDA margin expanding by **3.6** percentage basis from **13.2%** to **16.8%**



Portfolio review concluded

- Complexity removed, legal entity reduced from **34 to 5**
- Remaining subsidiaries retained for cross-border presence

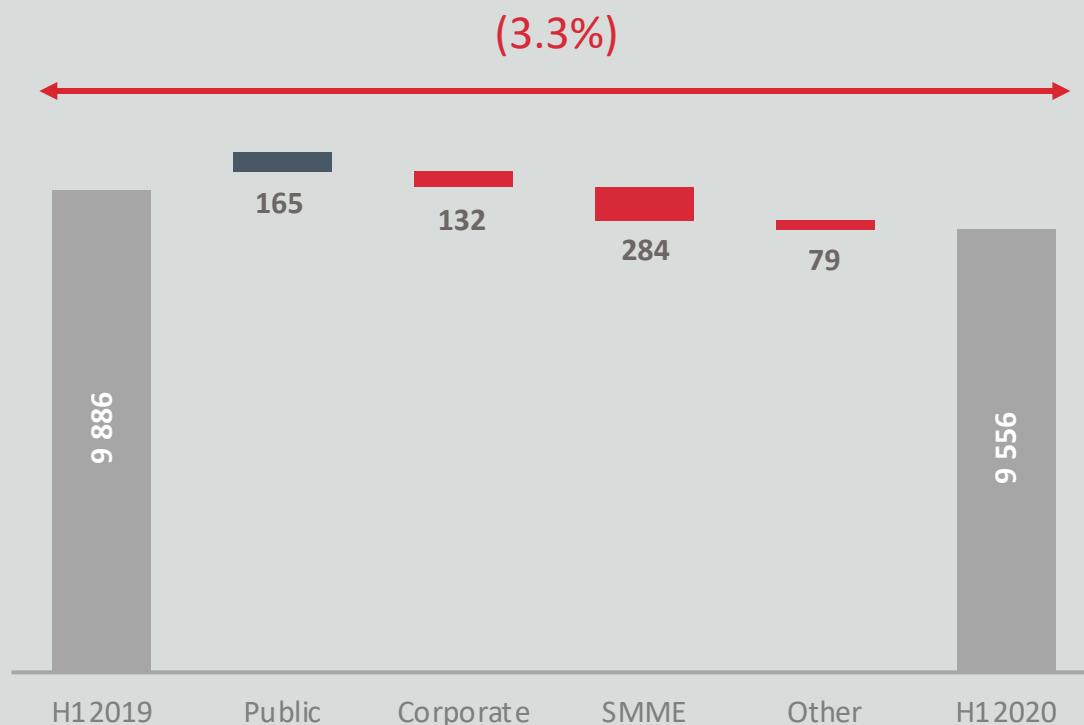


Increased focus on customer experience

- Improvement on the NPS score, this improvement is **4** points

Performance impacted by weak economy

Revenue by vertical segment



5% growth in public sector

- Public sector spend improved but not sustainable
- Continued growth in revenue from municipal solutions

4% decline in corporate sector

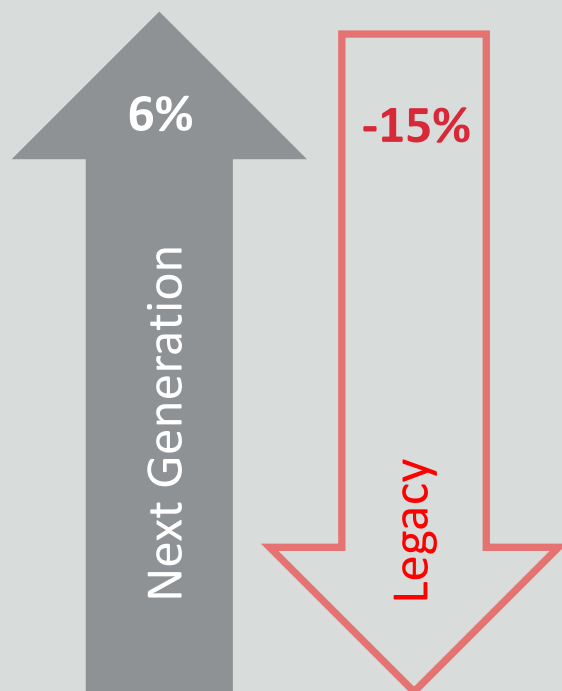
- Improved performance in financial services sector due to leading data network offerings
- Set off by pressure in the retail sector on voice, wireless and application solutions

10% decline in SMME

- Due to decreased voice and internet revenue

Growth in next generation technologies

Voice



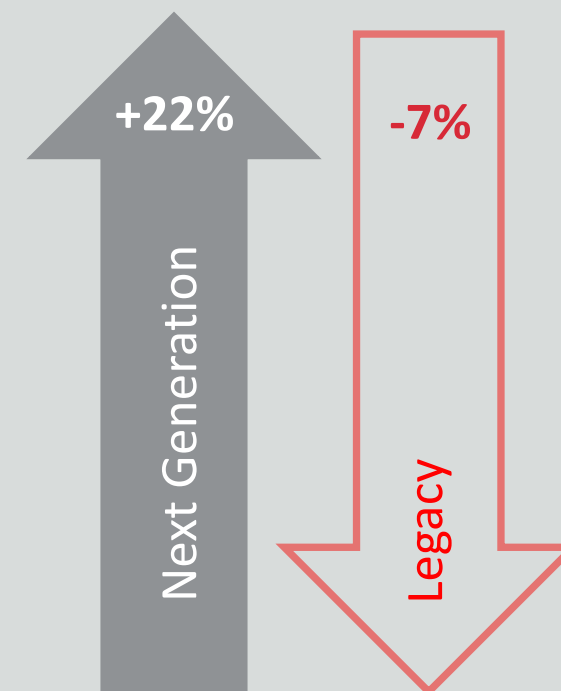
Next generation voice

- Revenue increased by **6%**, upgrade from legacy to new technology proceeding according to plan
- Next generation voice lines have increased by **16%** in line with our strategy to upgrade customers to next generation voice

Next generation data

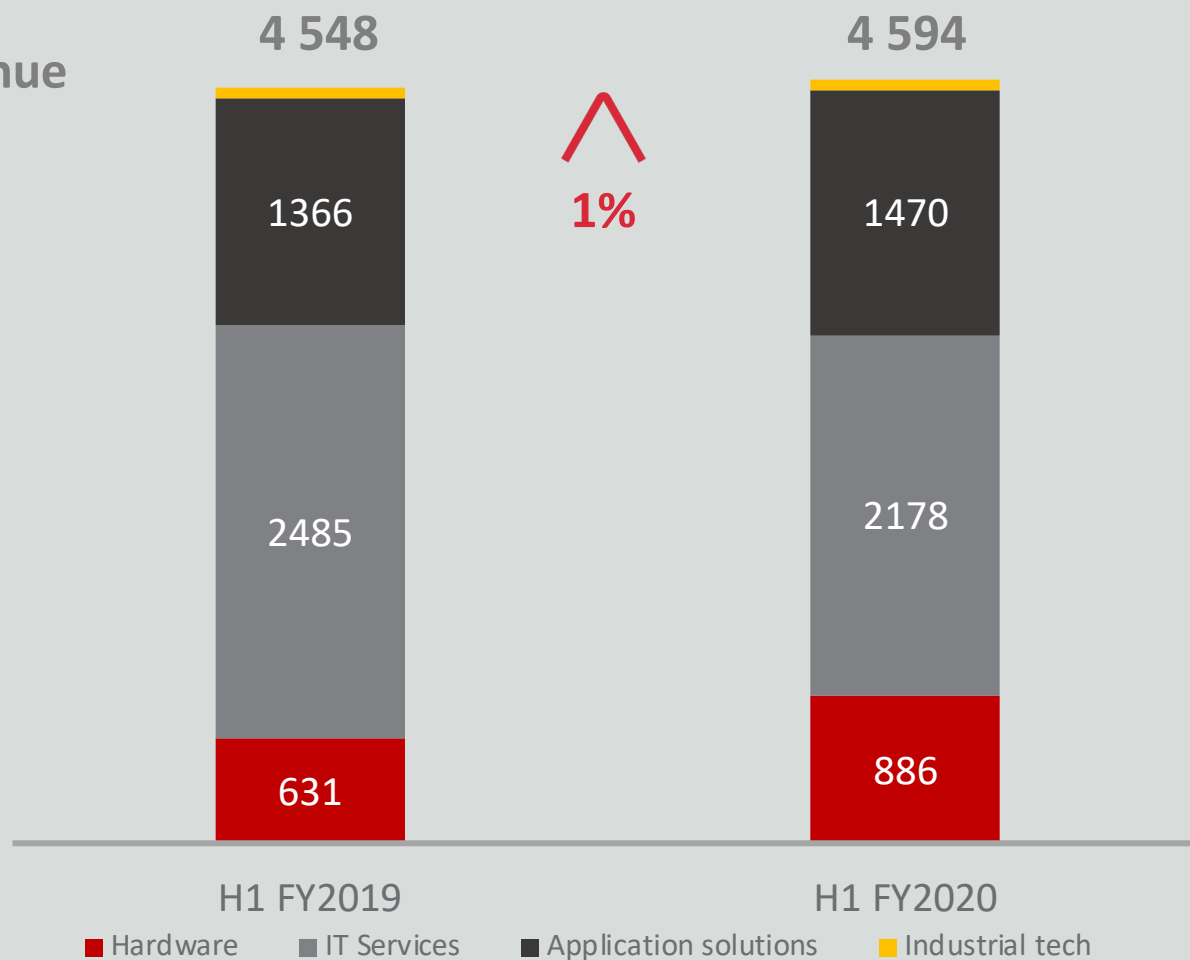
- Increased by **22%** as data demand continues to intensify
- Legacy data revenue decreased by **7%** due to upgrade from Diginet to Metro-Ethernet

Data



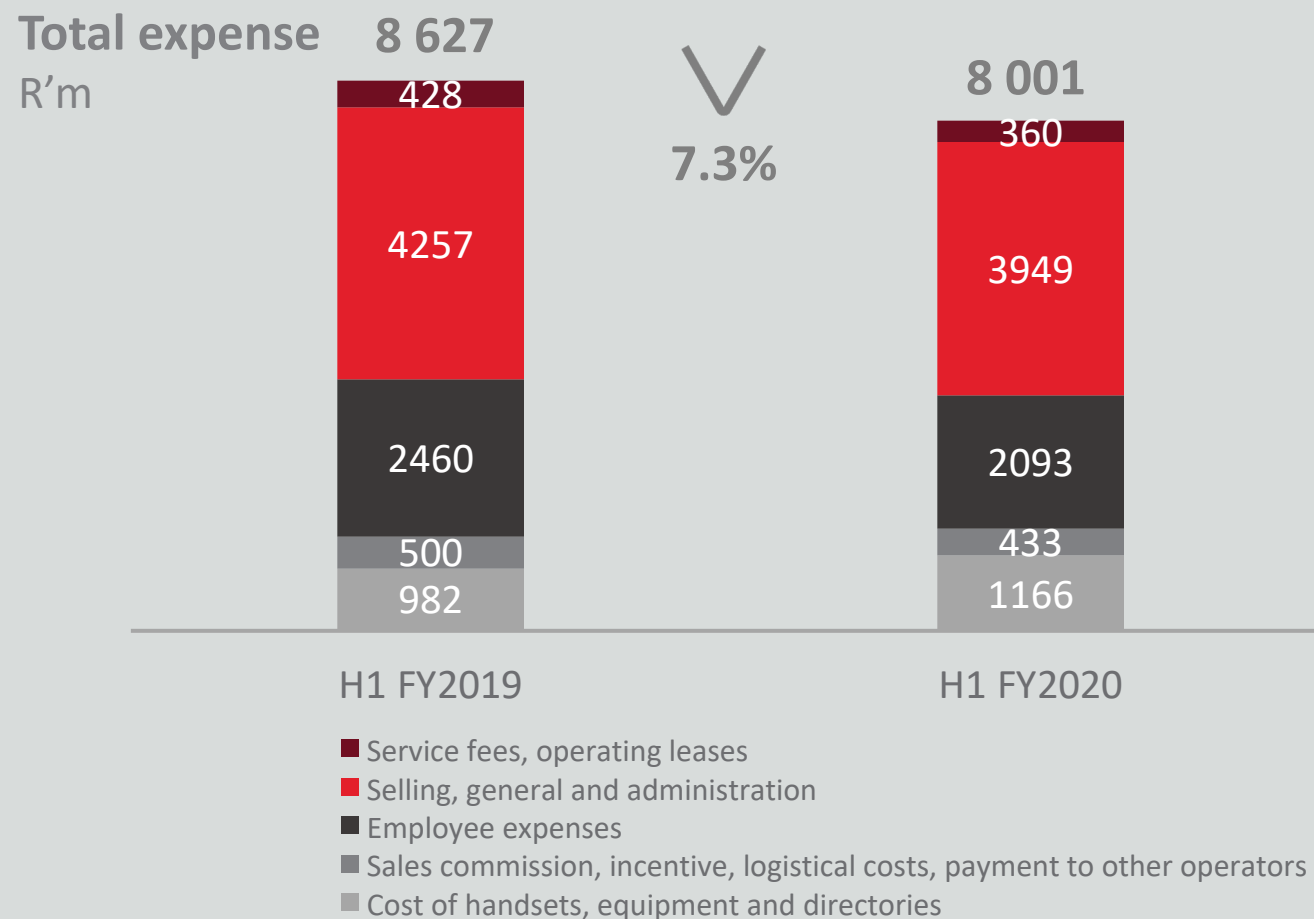
Stable IT business in a weak economy

Revenue
R'm

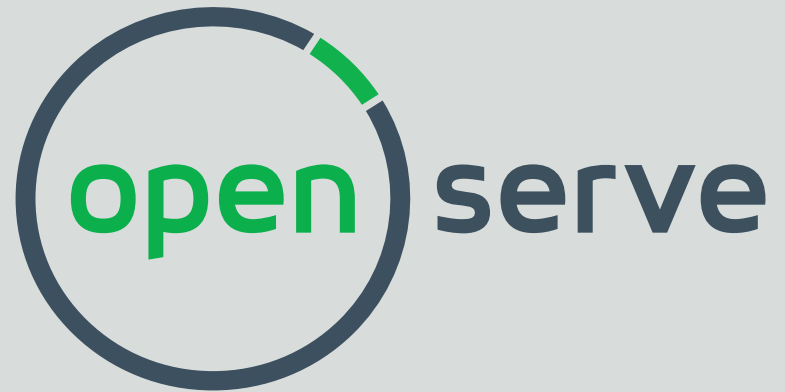


- **40.5%** increase in hardware sales, taking advantage of the customer refresh cycle
- **7.6%** increase in application solutions in line with strategy to grow own IP solutions
- **12.4%** decline in IT services as a result of the delayed launch of the BCX cloud platform and reduction in demand in the traditional hosting platform

Reduce cost to serve



- Margin expansion due **7%** reduction in costs, with **3%** reduction in revenue
- **15%** decrease in employee expenses, due to headcount reduction of **28%**
- **7%** decrease in selling, general and administration cost due to cost optimisation programme
- EBITDA margin improvement from **13.2%** to **16.8%**



Highlights

**42.6% FTTH
connectivity rate**

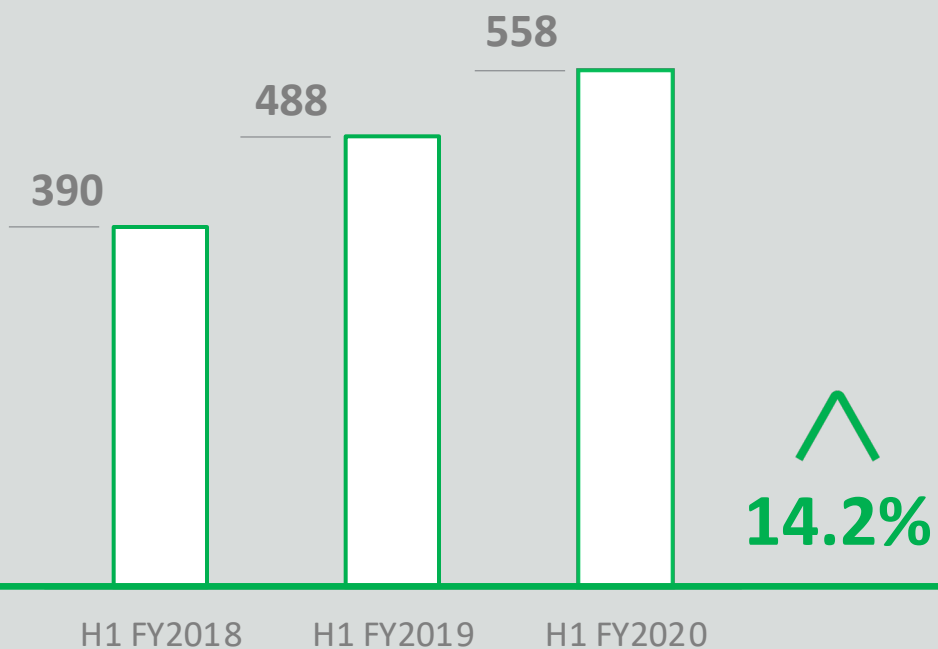
**14.2% growth in
fixed line
broadband data
consumption**

**28.5% growth in
Ethernet business**

Connectivity gateway

Fixed line broadband data consumption¹

Petabytes



Ethernet business

42 417

services
connected



28.5%

Fibre to the base stations

7 388

connected



7.4%

Homes connected

195 416

connectivity
rate of



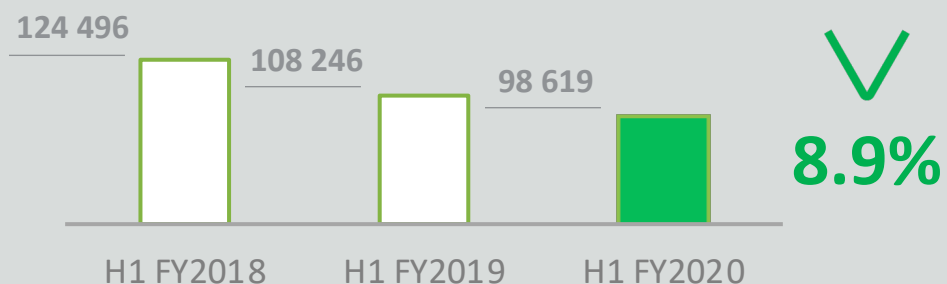
42.6%

Data eco-system evolution

Data solutions evolution

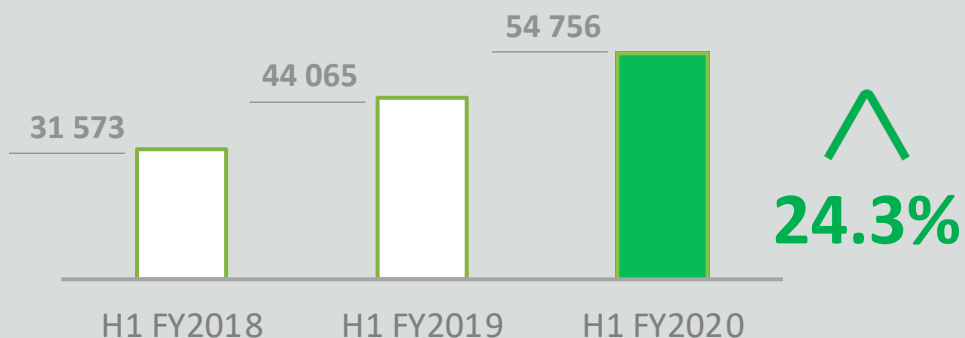
Legacy technology

Services



Next generation ethernet technology

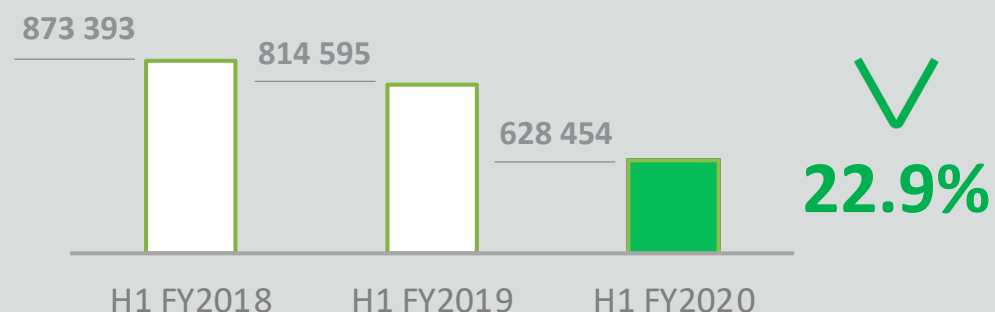
Services



Broadband connection evolution

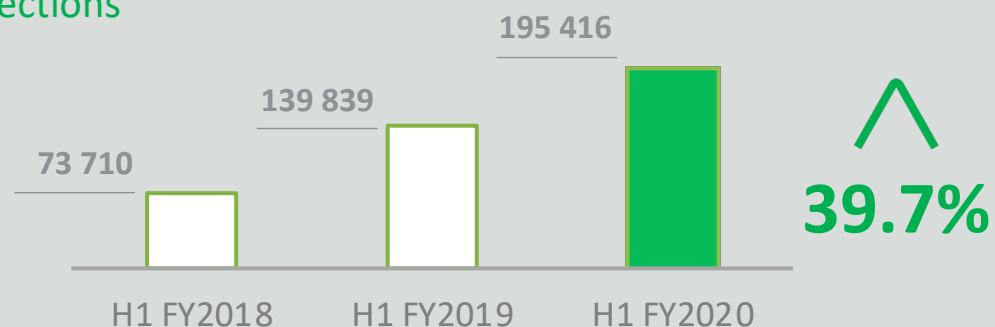
Copper access¹

Connections

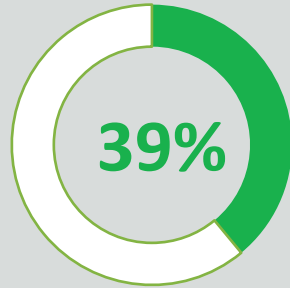


Fibre access

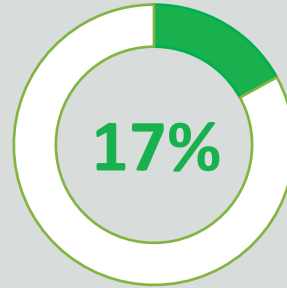
Connections



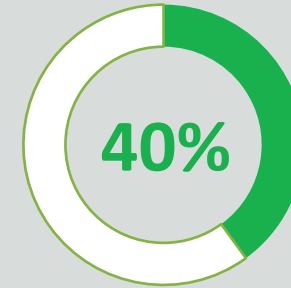
Improved operational efficiencies



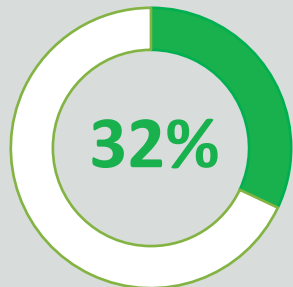
improvement on next generation access average time to install



improvement in broadband fault rate



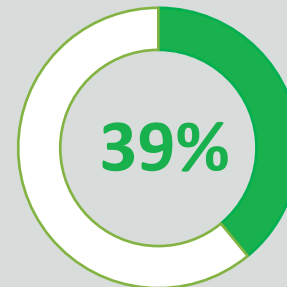
improvement on average time to repair



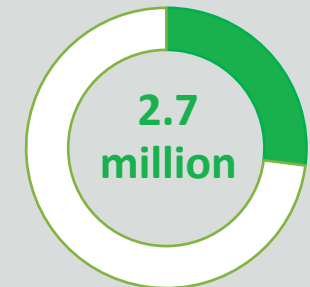
reduction in re-dispatch rate



improvement in interaction NPS



reduction in fault assurance visits



less kilometres travelled

Gyro

Highlights

**44.1% increase
in M&T revenue**

**11.4% growth
in total tenant**

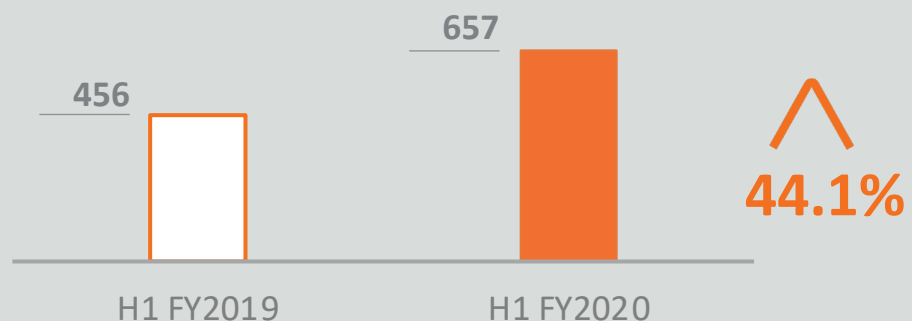
**18.5% growth in
EBITDA margin**

First 5G small cell site live

M&T Portfolio performance

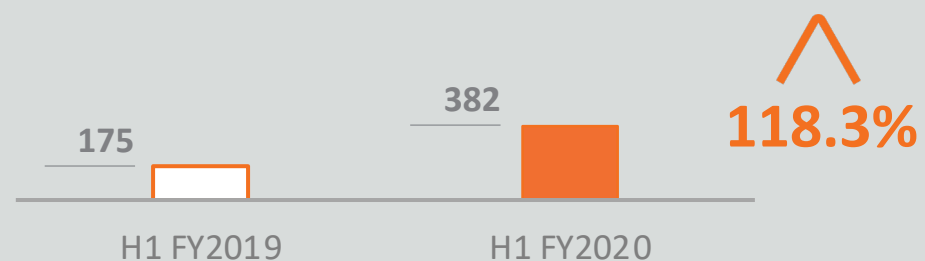
Revenue

R'm



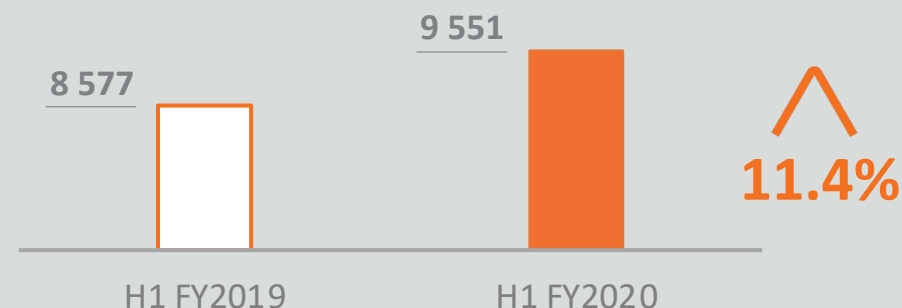
EBITDA

R'm



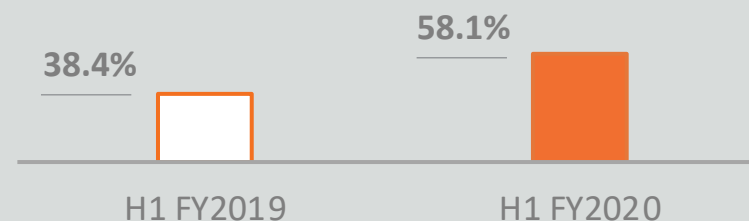
Total tenant growth

Number of leases



EBITDA margin

(%)



M&T portfolio: Independent valuation

FY2020 valuation considerations

Commercially
productive
portfolio



- Independent valuation based on a portfolio of 3 648 commercially productive towers

Future additional valuation considerations

Build-to-suit
sites



- Development of 2 000 towers over the next 3 years, driven mainly by demand from MNOs

Small cells



- New small cells and rooftop towers for densification and preparation for 5G

Portfolio valuation summary

Productive portfolio

3 648
towers

FY2020 EV/EBITDA
Multiple

11.2x

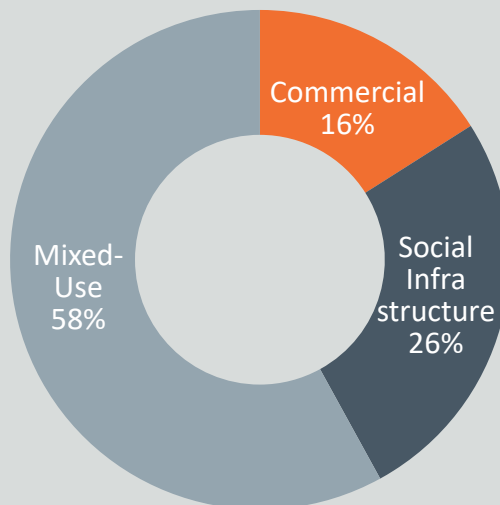
Portfolio valuation

R9.1
billion

Unlocking value

Property development pipeline – 16 Projects

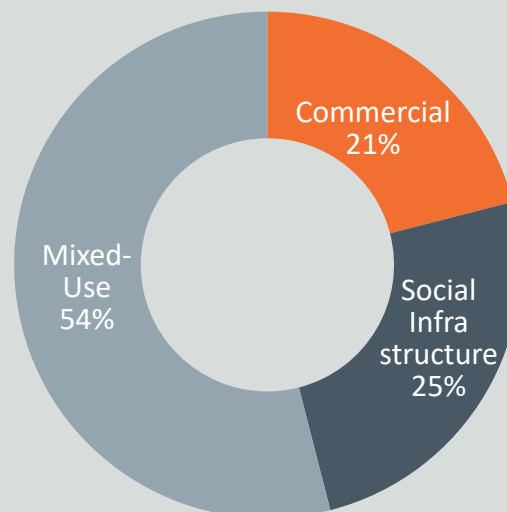
Sectoral spread
(CAPEX)



Note:

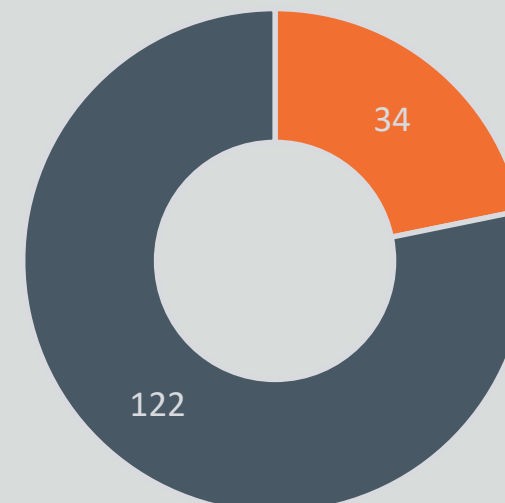
- **Mixed-use developments** (office, retail, residential and hospitality)
- **Commercial developments** (industrial, office and retail)
- **Social infrastructure developments** (residential, student accommodation and educational facilities)

Sectoral spread
(GLA)



Disposal pipeline

Identified disposal
properties (156)



Note:

- **Current sales properties**
- **Planned disposals**

Financial Overview

3

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Key factors impacting results



**Weak economic
environment**



**IFRS 16
adoption**



**Margin
pressure**







**Capex
acceleration**



**Financial risk
management**

IFRS 16 impact

CATEGORY	IAS 17 (Previous standard)	IFRS 16 (New standard)	IMPACT
Balance Sheet 	<ul style="list-style-type: none"> Lease smoothing receivable/payable 	<ul style="list-style-type: none"> Recognise right of use of asset Recognise lease liability 	<ul style="list-style-type: none"> R3.9bn R4bn
Income Statement 	<ul style="list-style-type: none"> Operating lease on straight line basis in operating expenses 	<ul style="list-style-type: none"> Reduced operating lease (higher EBITDA) Depreciation on right of use asset Interest expense on lease liability PAT HEPS 	<ul style="list-style-type: none"> R564m (R456m) (R183m) (R54m) (10.9 cents)
Cash Flow 	<ul style="list-style-type: none"> Lease payment in operating activities 	<ul style="list-style-type: none"> Lease payment in financing activities 	<ul style="list-style-type: none"> Reclassification on cash flow statement
Net Debt/ EBITDA 	<ul style="list-style-type: none"> Operating lease payment in EBITDA 	<ul style="list-style-type: none"> Higher EBITDA Higher net debt 	<ul style="list-style-type: none"> Increase by 0.2x

Group performance

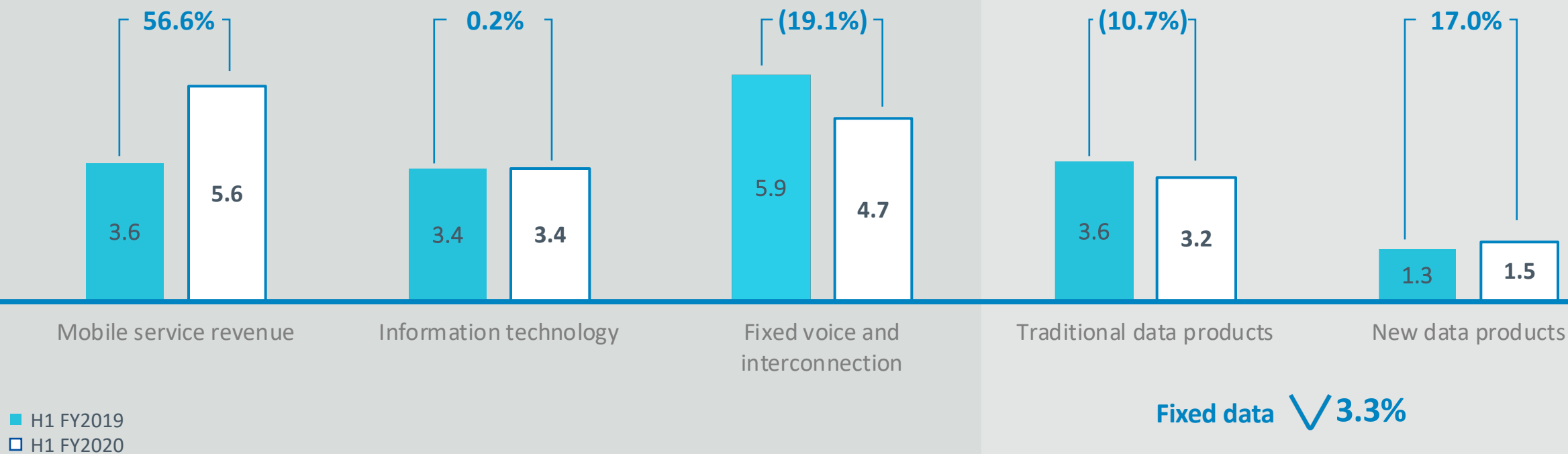
Rm	H1 FY2020 (IFRS 16)	H1 FY2020 (IAS 17)	H1 FY2019 (IAS 17)	%
Operating Revenue ¹	21 479	21 479	20 511	4.7
Direct expenses	5 726	5 726	4 200	(36.3)
Operating expenses (excl. depreciation)	10 471	11 035	11 236	1.8
EBITDA	5 604	5 040	5 267	(4.3)
Headline earnings per share (cents)	183.4	194.3	327.8	(40.7)
Interim dividend (cents)	71.5	71.5	112.1	(35.7)
Capital investments	4 238	4 238	3 276	29.4
Free cash flow	(1 267)	(1 267)	138	(1 018.1)

All commentary, messaging and indicators in this presentation for H1 FY2020 exclude the impact of the adoption of IFRS 16. The IFRS 16 impact is a decrease of R564m on operating leases and depreciation and finance charges increase by R456 million and R183 million respectively. The related tax impact is R21 million. The comparative period exclude voluntary severance package (VSP) and voluntary early retirement packages (VERP) of R282 million and the related tax impact of R80 million.

¹During the year we restated the prior period revenue by R337 million that relates to an erroneous consolidation of Smart Office Connexion, which was reported in March 2019.

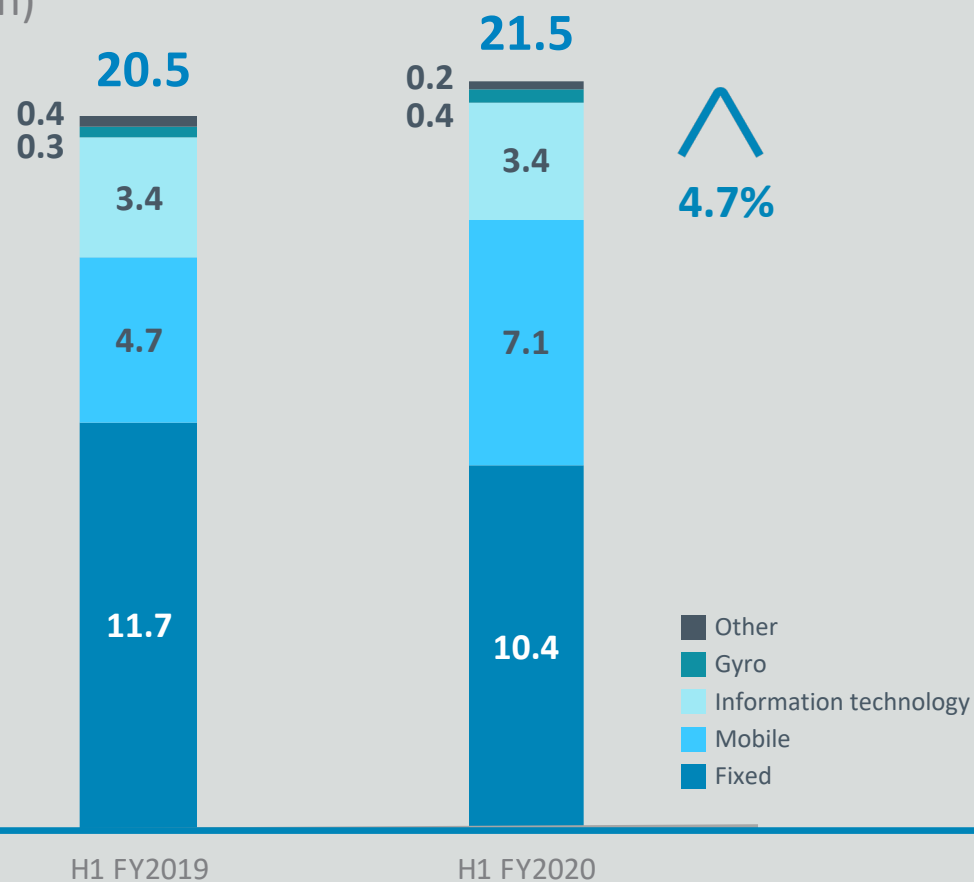
Investment strategy continue to bear fruit

Revenue by product line (R bn)

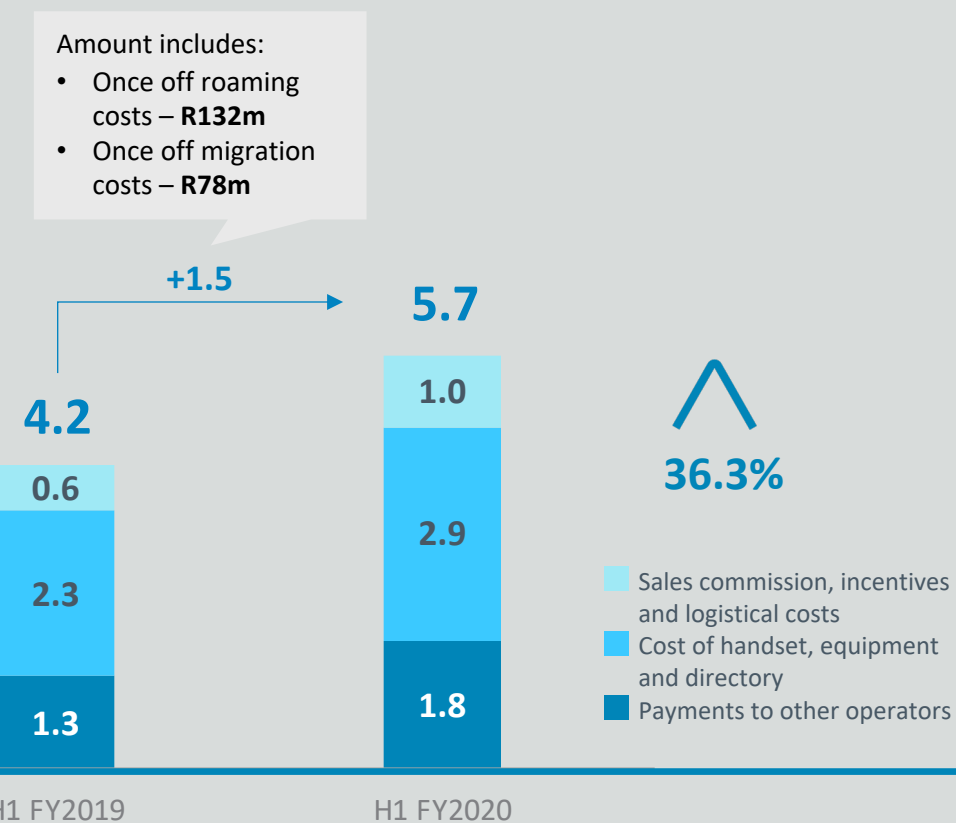


Higher direct expenses in support of mobile growth

Group revenue
(R bn)



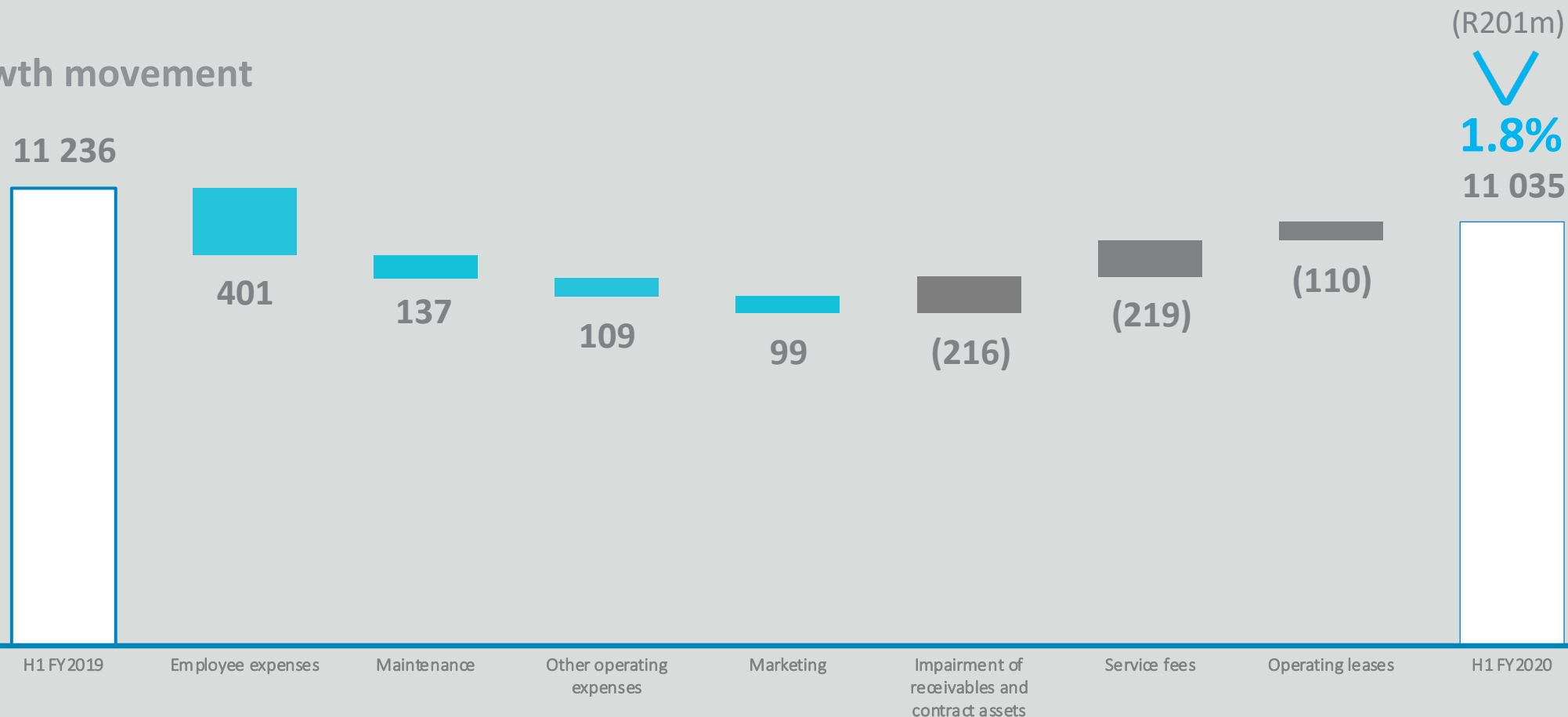
Direct expenses
(R bn)



Cost decrease supported by our cost optimisation program

Cost growth movement

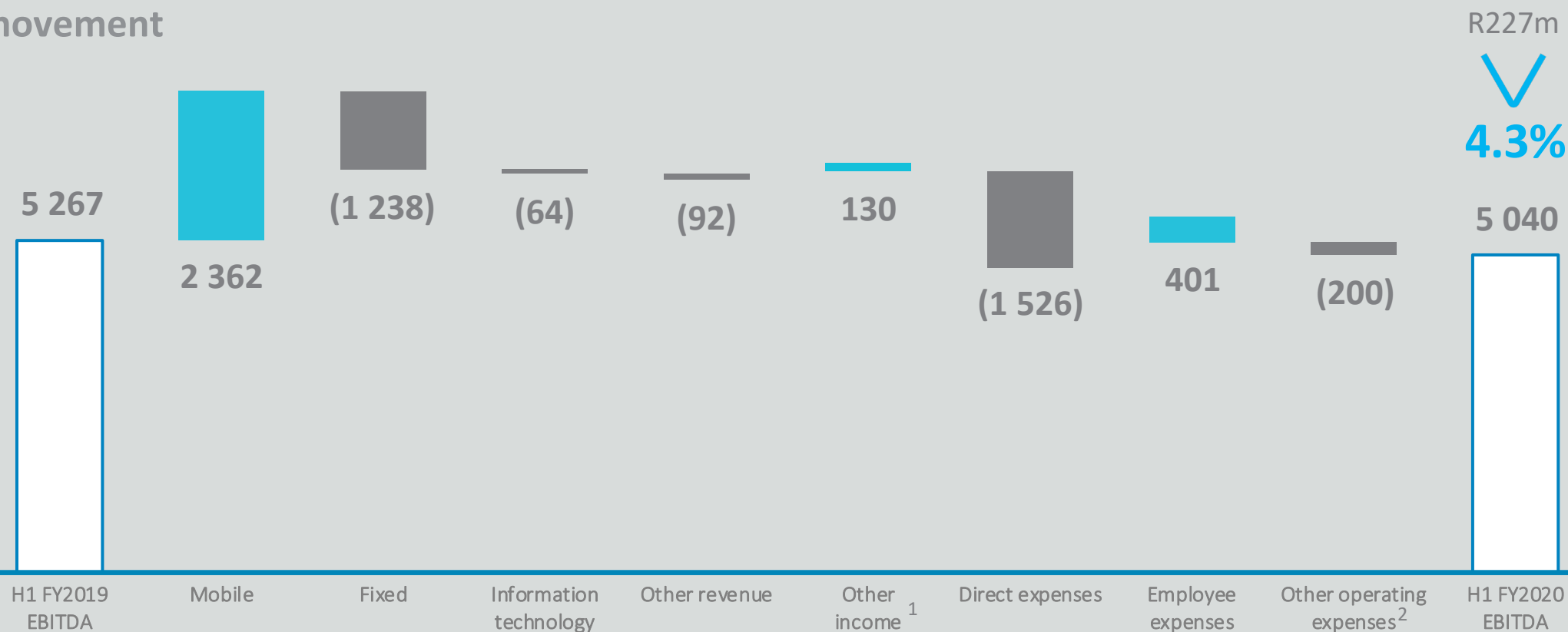
Rm



EBITDA impacted by higher acquisition costs

EBITDA movement

Rm



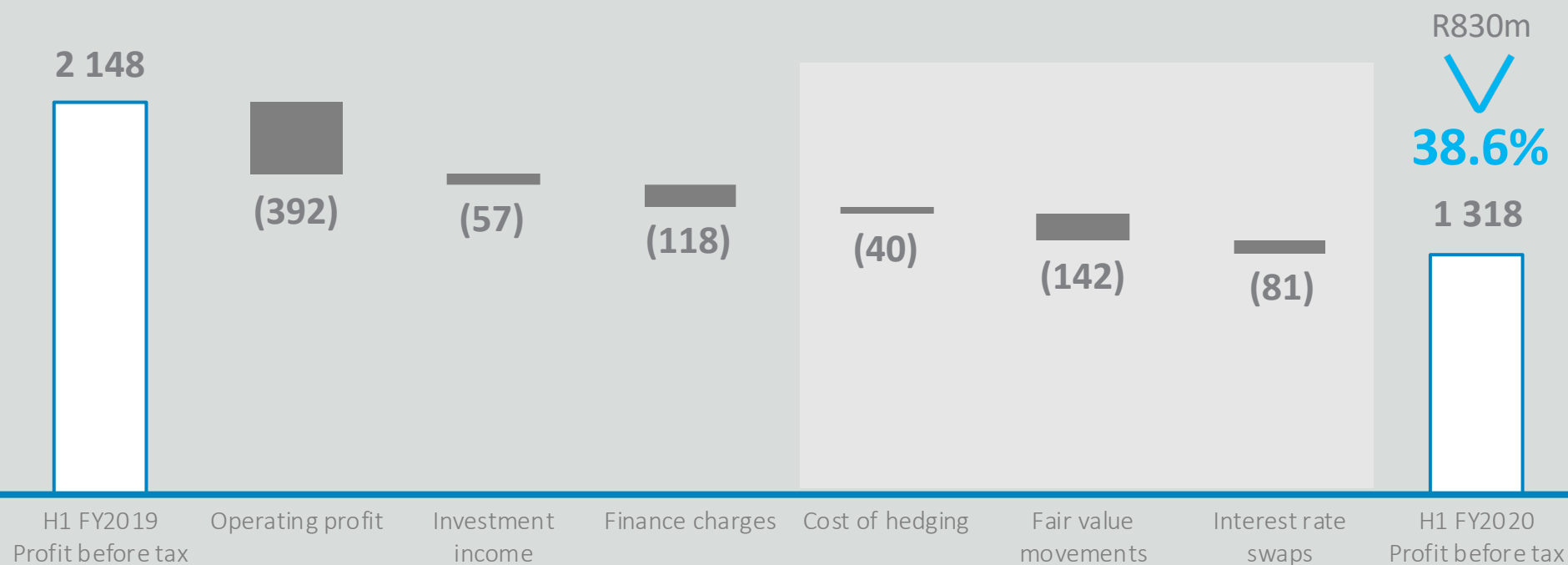
¹ Includes interest on debtors

² Includes other operating expenses, maintenance, marketing and impairment of receivables and contract assets, service fees and operating leases

Earnings decline due to fair value adjustments

Profit before tax movement

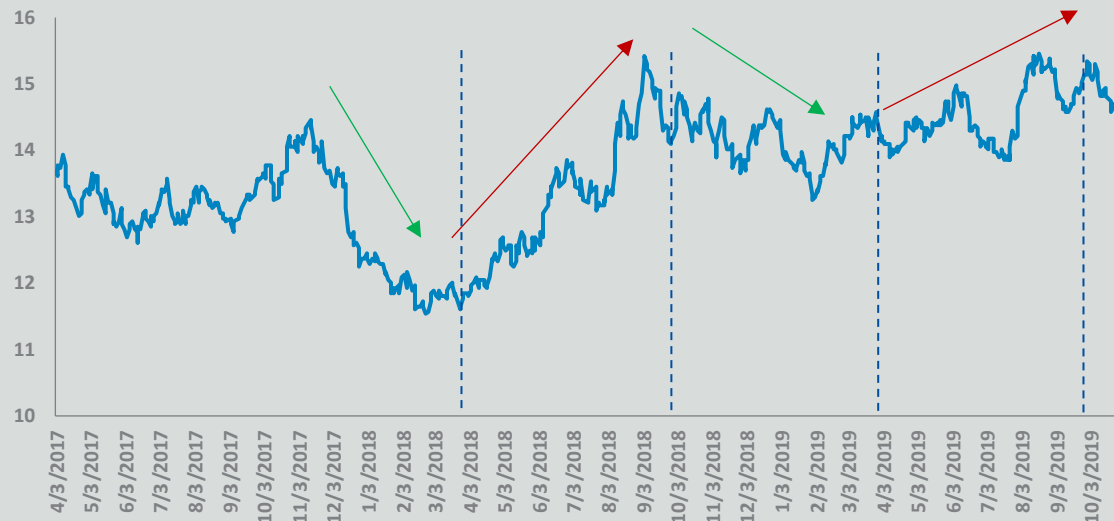
Rm



Impact of financial risk management

	Sep-19	Sep-18	Movement
Cost of hedging	116	76	(40)
Forex and fair value movements	22	(201)	(223)
Forex movements	(30)	(172)	(142)
Interest rate swaps	52	(29)	(81)

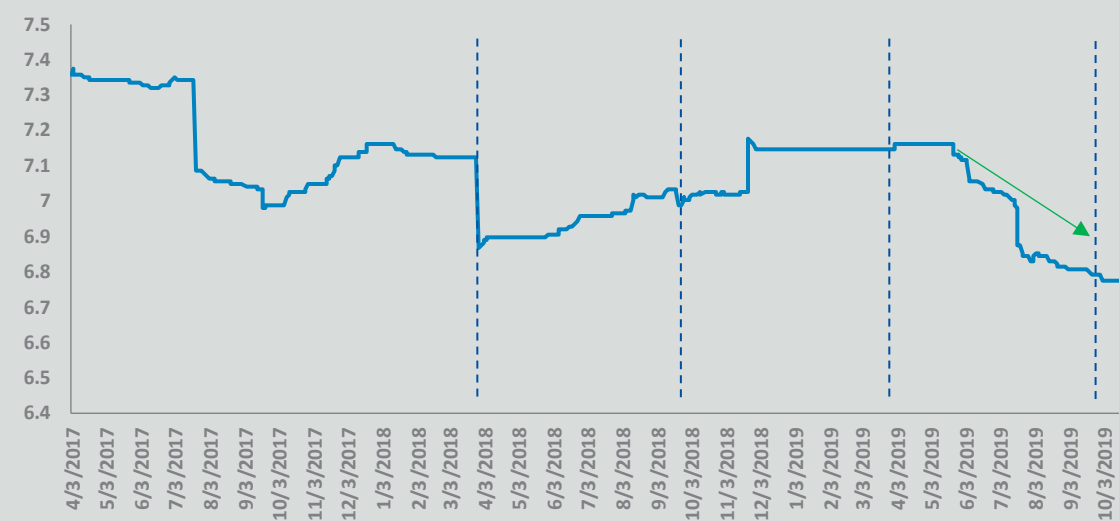
ZAR/USD historical exchange rates
(ZAR/USD)



Forward exchange contracts placed at favourable spot rate

	Sep-19 (IFRS16)	Sep-19 (IAS 17)	Sep-18 (IAS17)
Net finance charges	864	681	563
Movement	183	118	

3 Month - JIBAR
(%)



Lower interest rate environment in H1 results
in unfavourable interest rate swaps

Financial risk management - FY2016 to FY2020

	H1 FY2020	H1 FY2019	H1 FY2018	H1 FY2017
Foreign exchange and fair value movements	138	(125)	(6)	78
Cost of hedging	116	76	123	100
Forex & fair value movements	(30)	(172)	(119)	(40)
Interest rate swaps	52	(29)	(10)	18

	FY2019	FY2018	FY2017	FY2016
Foreign exchange and fair value movements	62	(42)	270	101
Cost of hedging	210	221	218	129
Forex & fair value movements	(167)	(269)	24	–
Interest rate swaps	19	6	28	(28)

Accelerated capex to support mobile expansion

	H1 FY2020	H1 FY2019	%
Mobile	2 246	1 352	66.1
Fibre	381	598	(36.3)
Core network	459	383	19.8
OSS/BSS programme	81	134	(39.6)
Network rehabilitation/sustainment	76	81	(6.2)
Service on demand	551	560	(1.6)
Other and subsidiaries	444	168	164.3
Total capital expenditure	4 238	3 276	29.4

Free cash flow impacted by accelerated capex

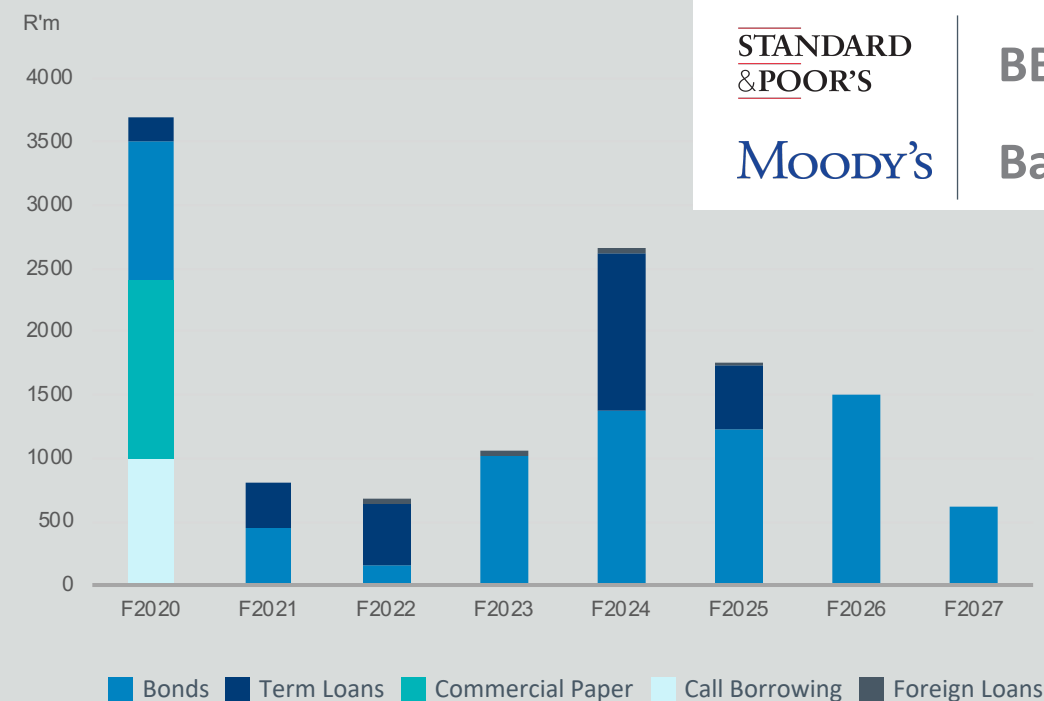
Free cash flow (FCF) movement Rm	H1 FY2020	H1 FY2019	%
Cash generated from operations	4 446	3 988	11.5
Repayment of lease liability	(389)	–	(100.0)
Interest received	116	185	(37.3)
Finance charges paid	(646)	(342)	(88.9)
Taxation paid	(753)	(483)	(55.9)
Operating free cash flow before capital expenditure	2 774	3 348	(17.1)
Cash paid for capital expenditure	(4 203)	(3 210)	(30.9)
Free cash flow	(1 429)	138	(1 135.5)
VSP, VERP and section 189 costs paid	162	–	100.0
Adjusted free cash flow	(1 267)	138	(1 018.1)

Healthy balance sheet

	H1 FY2020	FY2019	%
Cash balances	1 002	1 428	(29.8)
<i>Interest bearing debt</i>			
Opening balance	10 241	9 397	(9.0)
Net Funding raised	2 395	702	(241.2)
Other	141	142	(75.4)
Closing balance	12 777	10 241	(25.8)
Net debt*	11 775	8 813	(33.6)
Net debt/EBITDA (times)*	1.2	0.8	0.4
Average cost of debt (%)	9.7	9.6	0.1

*Excludes the impact of IFRS 16

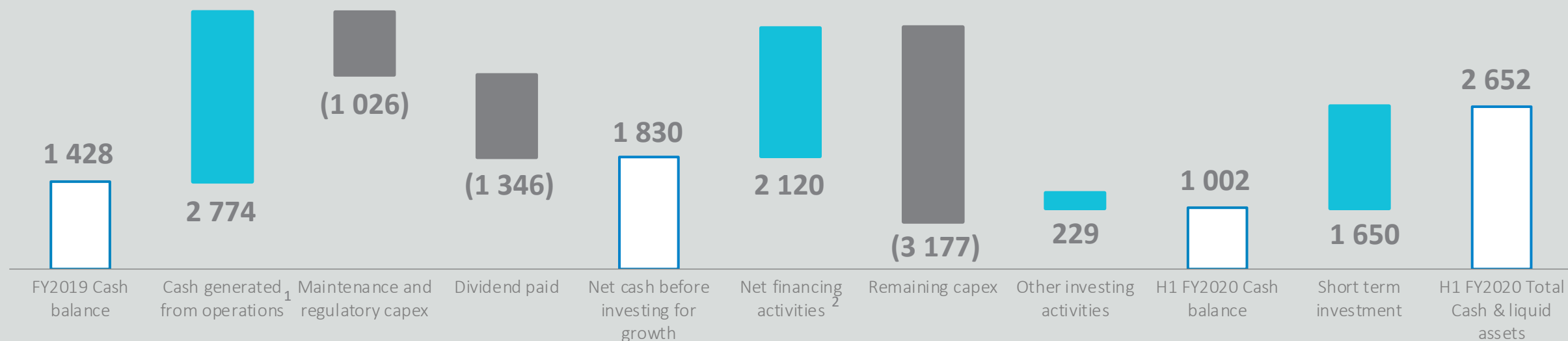
Debt maturity profile



- Total gross debt R12.8 billion (H1 FY2019 R10.2 billion)
- R1.5 billion of TL20 switched to a new five and seven year bond
- ECA funding secured in October 2019 with a 10 year tenure

Disciplined cash management





Rm



¹Includes the cash payment of R162 million relating to VSP, VERP and section 189 costs

²Includes net funding raised of R2 395m and net proceeds from derivatives

Progress against guidance

	FY2019 – FY2021 Guidance*	H1 FY2020 Actual	FY2020 – FY2021 Updated Guidance*
 Operating revenue	Mid-single digit	4.7%	Mid-single digit
 EBITDA	Mid-single digit	(4.3%)	Mid-single digit
 Capex to revenue	16% - 20%	19.7%	16% - 20%
 Net debt to EBITDA (times)	1x (pre IFRS 16) 1.2x (post IFRS 16)	1.2x (pre IFRS 16) 1.4x (post IFRS 16)	≤ 1.5X (post IFRS 16)

Sustainable financial framework



Defend and grow

Protect decline in legacy business:

- Upgrade customers to new technologies

Accelerate new revenue streams:

- Mobile, M&T, IT Solutions



Sustainable cost management

Effectively manage and contain cost escalation:

- External Spend
- Process & Organisation
- Rationalise IT landscape
- Reduce Cost-to-serve



Disciplined capital allocation framework

Framework that supports our sustainable value creation:



- Capital & Operational productivity
- Maintain a healthy balance sheet
- Optimal capital prioritisation criteria
- Maximise shareholder returns



Positive free cash flow

- Optimise net working capital
- Supply chain financing
- Handset financing
- Opportunistic sale of non-core assets

Sustainable cost management

Targets		Measured against H1 FY2020 actuals		H2 quick win initiatives <i>Non-exhaustive</i>
Cost to revenue	75% to 73% by FY2022	Cost to revenue ratio	78% 	3 rd party contracts review
Limit cost escalation	To below inflation	Opex below inflation	Opex reduced 1.8% 	Reduce cost to acquire/serve
				Optimize network utilisation
				IT simplification and rationalisation
				Various opex initiatives

H2 Cost to Revenue target of 75%

Improve operating free cash flow



H2 KEY INITIATIVES

R700m - R1bn target



**Supply chain
financing**

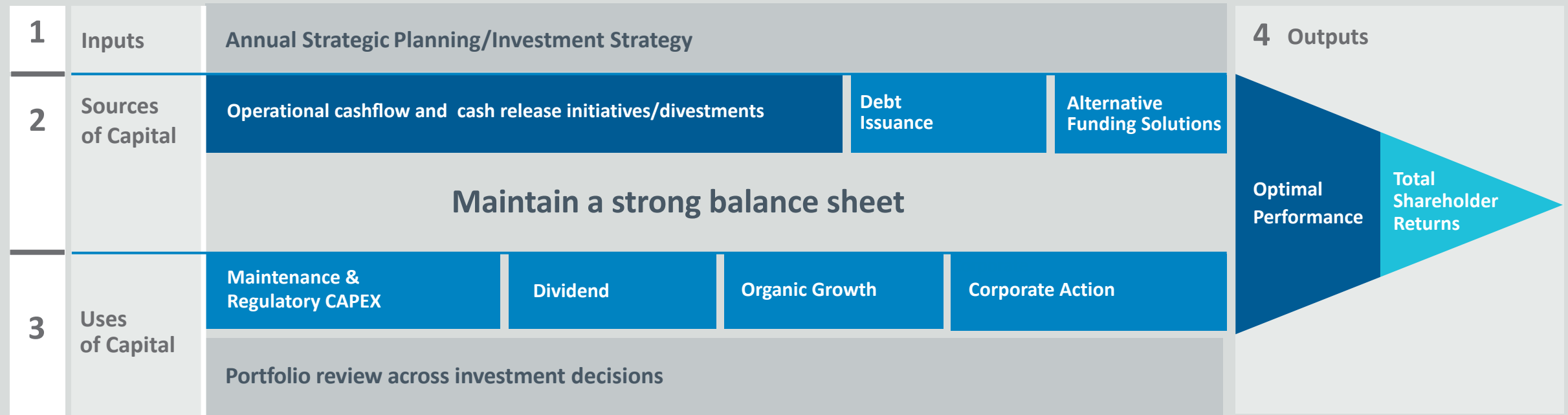


**Handsets
receivables financing**



**Disposal of
non-core assets**

Capital allocation framework



Dividend policy will be reviewed in H2 in line with Capital Allocation Framework

Conclusion

4

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Business evolution

5

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Benefits of the operating model



Profit accountability

- Transparency of individual BU performance
- Segment P&L reporting
- Transfer pricing for transactions between BUs implemented



Commercial focus

- Standalone BUs
- Customer segmentation
- Increased focus on respective markets
- Improved BU identity and ownership of business



Cost & capital efficiency

- Focus on BU cost structures to extract efficiencies
- Focus on different BU capital requirements
- Manage BUs based on different return profiles



Regulatory compliance

- Trading model between BUs implemented
- Open access wholesale products
- Separation facilitates regulatory approval for inorganic growth



Strategic flexibility

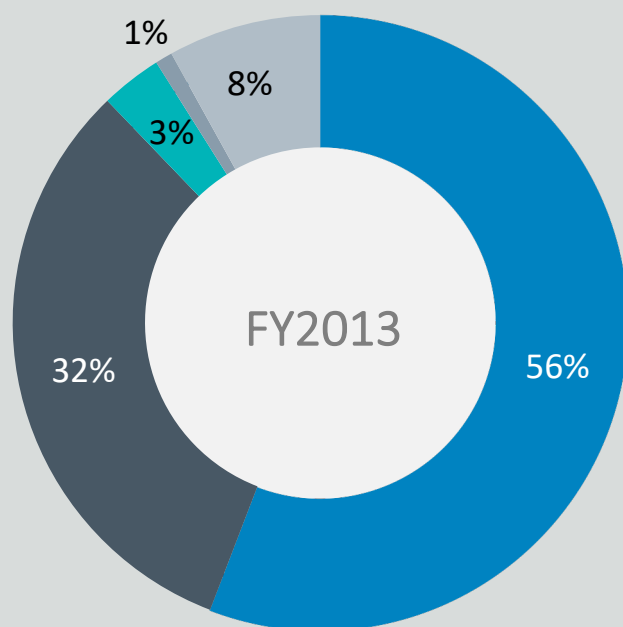
- Identify specific needs of the individual BUs
- Partnerships can be aligned to BU specific needs
- Different partnership options can be implemented



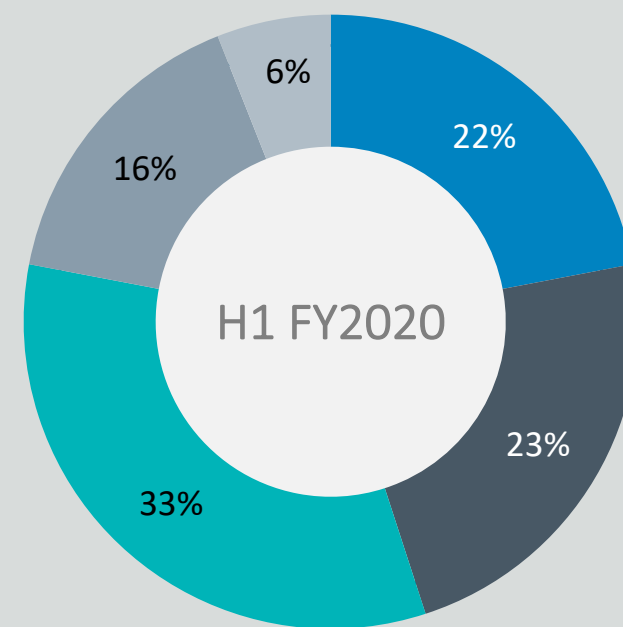
Value realisation

- Valuation improved over the years
- Sum of the parts not achieved yet

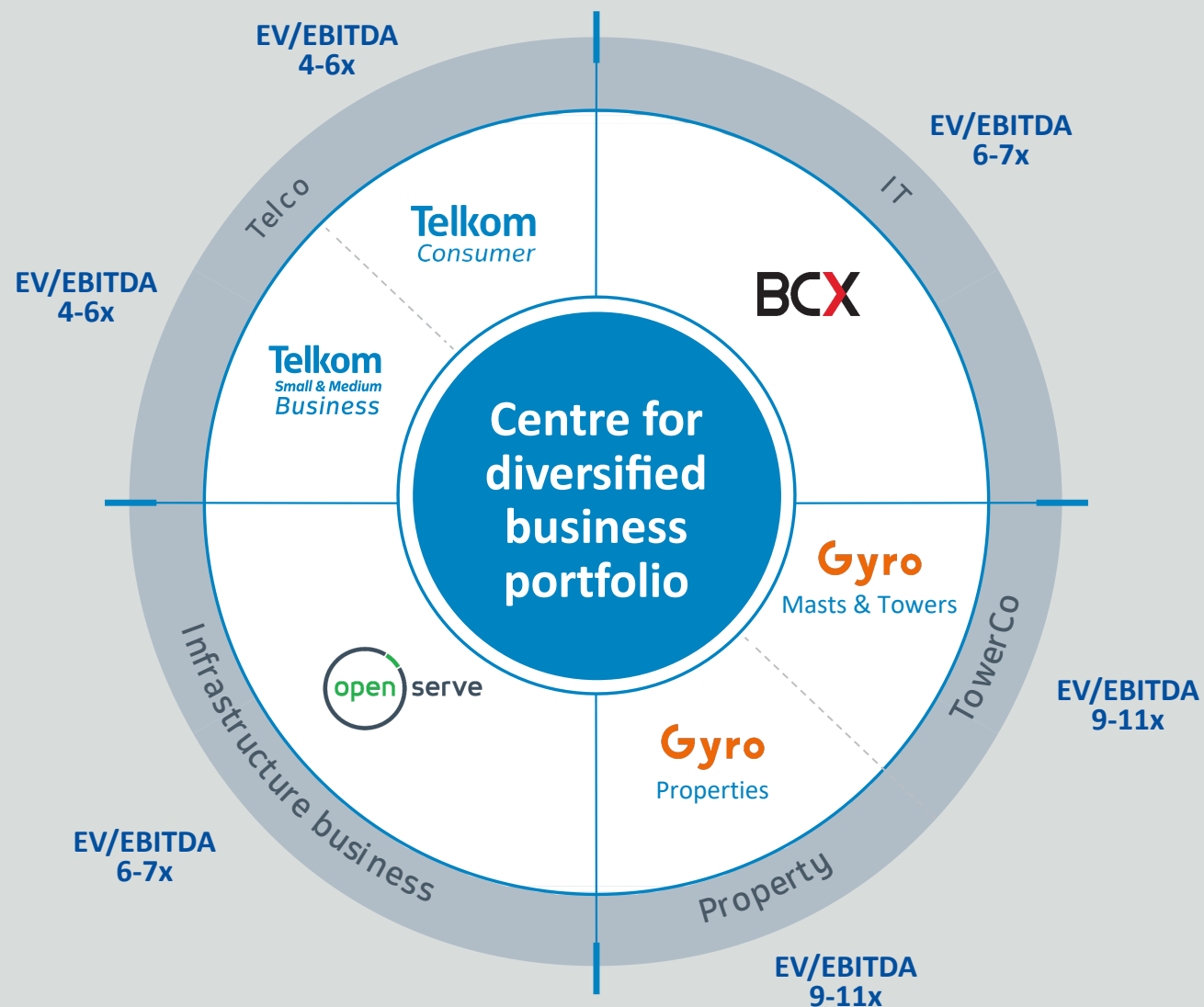
Evidence of the evolution



- Fixed voice
- Fixed data
- Mobile
- IT
- Other



Market beginning to recognise evolution



Diversified portfolio – set for growth

Telkom Consumer

- Accelerate mobile growth
- Drive high-speed broadband
- Network expansion
- Content and VAS
- Improve customer experience

BCX

- Drive new profitable revenue streams
- Grow connectivity
- Improve profitability of IT services
- Reduce cost to serve

open serve

- Modernise the network
- Commercialise the network
- Transforming service delivery

Gyro

- Optimise and grow the Mast & Tower portfolio
- Commercialise the property portfolio
- Enhance building operation efficiencies

Telkom Small & Medium Business

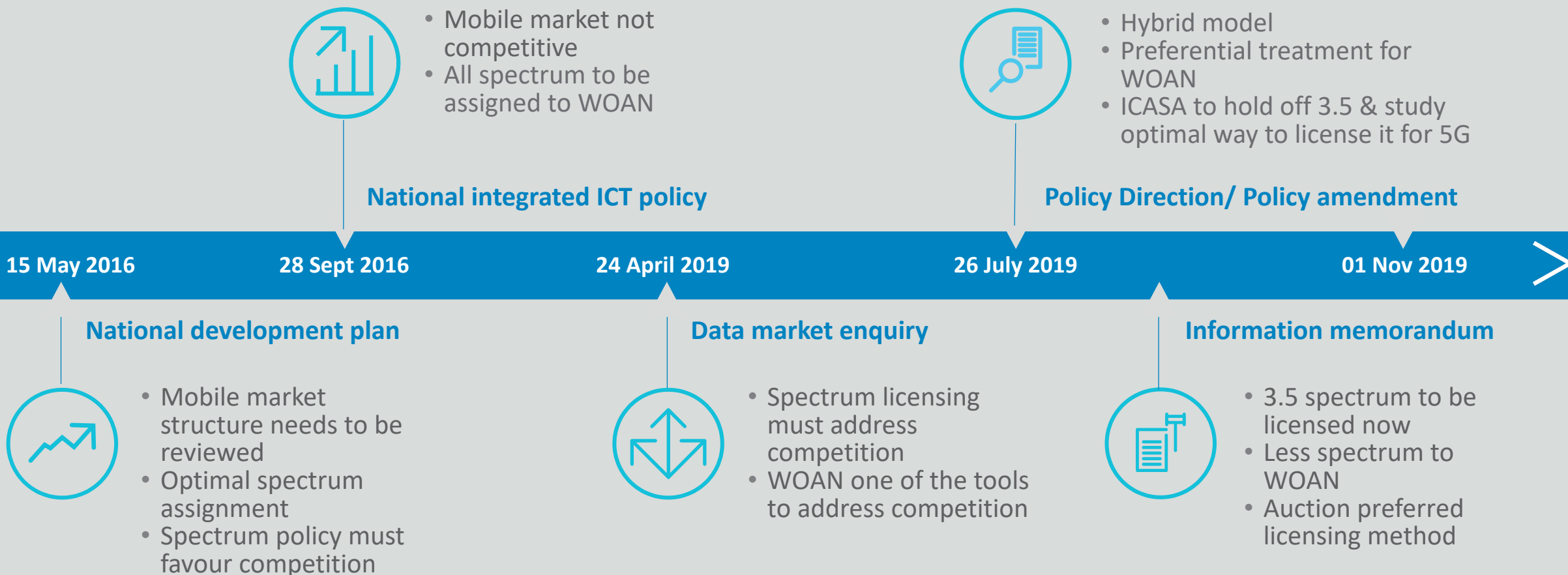
- Establish dedicated SMB BU
- Aggressive on new propositions
- Build a digital platform led business
- Introduce adjacent market products through an eMarket place

Spectrum assignment

6

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Spectrum journey remains complicated and uncertain



Spectrum assignment principles and legislative imperatives

Spectrum assignment to Address key principles



Promotes competition and
drives economic growth



Efficient utilization of scarce
resources



Promotes investment and
innovation

ICASA legislative imperatives and considerations for spectrum licensing



ss 2, 3 & 31(3) of the ECA



Radio Frequency Spectrum
Regulations 2015



National Integrated
ICT Policy



Policy Directions

Information Memorandum inconsistent with policy directive



Not informed by economics and competition

- Disregards the current market structure and competition dynamics
- Not clear what future market structure is intended



Proposed spectrum lots are technically flawed

- 700 and 800 MHz are not commercially and technically available
- 3.5 GHz (5G) - requires 100 MHz of contiguous spectrum - only 116 MHz is available



Unrealistic Spectrum Obligations

- Extensive capital outlay required to meet the speed and coverage obligations



Non Viable WOAN

- No discernible WOAN construct
- Amount of spectrum assigned not sufficient for WOAN to be effective

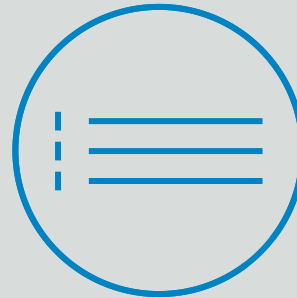
Proposed consultation process

**Public comments
on information
memorandum**

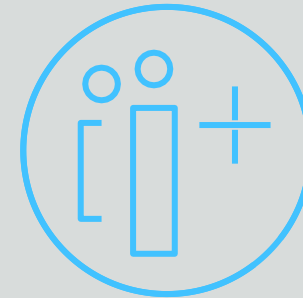
31 January 2020



**Evaluation of
submissions by
ICASA**



**Invitation to
apply (ITA)**



Telkom SA SOC Limited

Thank you Q&A

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Telkom