

Conference call transcript

18 November 2024

INTERIM RESULTS CONFERENCE CALL

Operator

Good day, ladies and gentlemen and welcome to the Telkom interim results for the six months ended 30 September 2024. All participants will be in listen-only mode. There will be an opportunity to ask questions later during the conference. If you should need assistance during the call, please signal an operator by pressing * and then 0. Please note that this call is being recorded. I would now like to turn the conference over to Serame Taukobong. Please go ahead, sir.

Nondyebo Mqulwana

Good afternoon, everyone. It's Nondyebo Mqulwana speaking. I'm the Head of Investor Relations at Telkom. Welcome to our Q&A session for the interim results we published earlier this morning. On the call with me, I have our group CEO, Mr Serame Taukobong, as well as our group CFO, Mrs Nonkululeko Dlamini, as well as the investor relations team. Just to talk through the order of the call, Serame will take us through some key messages on our results, and then we will take your questions. The call is set to conclude at 17:00, depending on the interactions. Over to you, Serame.

Serame Taukobong

Thank you kindly, madam. Greetings to everyone on the call. I'll take you to the highlights of our interim results. Our strategy continues to drive performance. Our results for the period demonstrate a robust and steady operational performance, building on the progress made in the previous year. We saw solid data-driven growth driven by compelling data propositions. Cost optimisation programmes yielded the results desired. We sustained positive free cash flow. The Telkom Retirement Fund was successfully converted into a defined contribution fund. Smart capex investment and monetisation of our infrastructure continues as well as execution on disposals of non-core assets.

Group revenue grew with mobile data revenue increasing by 12.7% and a 15.5% growth in fibre data revenue. Our adjusted EBITDA improved impressively to R5.6 billion, yielding an EBITDA margin of 26.2%. We have a much stronger and healthier balance sheet, with an improved adjusted net debt to EBITDA. Free cash flow improved to R768 million. Execution on disposal of non-core assets. Gyro realised R204 million from property sales with 39 properties in the conveyancing process. On the Swiftnet transaction, we obtained the Competition Tribunal's approval and we are awaiting ICASA's license transfer approval.

Key highlights of the performance of our business units. Our mobile business delivered a performance that was ahead of the market, growing service revenue by 10%, with total mobile subscriber growth of 24% to 22 million subscribers. Prepaid subscribers increased by 29.1%, whilst maintaining a stable ARPU of R61. On the data front, mobile data subscribers increased by 19.6%, surpassing the mark of 14 million subscribers.

Openserve grew total next generation revenue by 5.6 percentage points. Next generation revenue for the business now constitutes 80.9% of operating revenue, up from 74% in the previous period. Openserve's connect-led strategy continues to deliver a market-leading connectivity rate, which is at 49.7% for the period. Openserve continues to invest in the last mile, with homes passed increasing by 11.9%, and homes connected by 18.1%.

BCX IT revenue is holding stable. For BCX, we continue to focus on the following. Growing IT service revenue and improving margins. Cost containment and right sizing the business. Approximately 400 people have exited in this regard. Portfolio optimisation and sales effectiveness, as well as protecting the converged communications revenue through phase migration. I will now hand over to the operator for Q&A.

Operator

Thank you. Ladies and gentlemen, if you would like to ask a question, you may press * and the on your touchtone phone or on the keypad on your screen. You will hear a confirmation tone that you have joined the queue. If you wish to withdraw your question, you may press * and then 2 to remove yourself from the question queue. Once again, if you would like to ask a question, you may press * and then 1. The first question we have is from Myuran Rajaratnam of MIBFA. Please go ahead.

Myuran Rajaratnam

Hi. Thanks for the opportunity to ask some questions. The Competition Tribunal ruling on the CIVH deal, in a bizarre sort of circumstances, it's positive either way they rule in the sense that if they rule positively and allow the deal to go ahead, there are more suitors available for Telkom, including potentially MTN who can come back. And if they rule against it, then does this not give you an opportunity to get ahead of the competition because your primary competitor in this space is cash flow starved and debt burdened in some sense on the fibre to the home and fibre to the base station and so on?

So, is this not an opportunity, especially since you are seeing some unexpected positive windfalls from things like property? I think R250 million this half, and there's potentially R700 million, so let's call it R1 billion. Is it not worthwhile giving that to Elton and let him go a bit wild and build it out while the friendly chaps in Stellenbosch are waiting? Thank you.

Serame Taukobong

Thank you, Byron. I'm sure Elton would love to hear your words. So, on a serious note, I think with or without the ruling, our strategy is clear. I think we've set our blue path. And you're absolutely right. I think the key focus for us is we continue on our path, and especially if you look at what has been published in terms of the competition slowing down on their rate of acceleration. We have continued with our connect-led and responsible rate of acquisition, which we will continue to do so.

I think the key focus, as we've always said, is we drive Openserve on balancing homes passed with homes connected to ensure that it is a more efficient way of deploying our capex, making sure that where we're passing the homes, it is capturing the right audience that will ensure that we connect those homes that we pass and drive the right return on our investment. So yes, Byron, we will certainly continue on the strategy that we are on.

Myuran Rajaratnam

Great. Thank you. I'll go back in the queue, see if anybody else wants to ask questions. Thank you.

Operator

The next question we have is from Preshendran Odayar of CIB. Please go ahead.

Preshendran Odayar

Hi guys. So yes, congrats on the results. A few questions from me. Staff cost in Gyro was very low in this period. It showed R19 million in the results released. Is that right? And why was it so low? And what is the run rate you can expect for the rest of the year? And also, there was an amount in Gyro of R163 million in other income. If you can just please unpack that.

And last question just on the Google agreement because I've got a few clients asking me questions about this. Because I remember it being a bit of a prepayment that they had made to you, and you had also prepaid for the right to use the two of those cable strands. And I think Google was paying you for the landing site and services once it hit South African shores. Without divulging any of the commercially sensitive information, can you just talk us through the mechanics and the numbers around that? Because I think a lot of guys are getting confused with what you disclosed about the R1 billion effect on this. Yeah, that's it for me. Thanks.

Nonkululeko Dlamini

Thank you, Presh. Maybe let me start with the Google transaction. Indeed, this is coming from as far back as 2023, which was H1 of 2024, where between ourselves as Telkom and Google, we entered into, call it back to back, where there was going to be some arrangements for them to utilise the landing station, and we would have their fibre repair arrangement on their side as well. What that meant then was that there was a back-to-back contract where they would make payments to Telkom but would also make payments to them.

The difference that you see of R1 billion is really a timing difference, if you like, because in the total contractual arrangement, net-to-net, we were going to be almost neutral. It's just that when the payment process started, which was in H1 2024, there was a payment incoming from Google as a portion of what their portion would be of the upfront payments that we were to make. And Telkom's one was a bit lagging, which is why you are seeing R1 billion from Telkom now. So, if you look at it net to net from the portion that Google would have paid us in the 2024 financial year, and the outflow from Telkom, it is basically then covering all the upfront payments that we agreed.

And the unwinding process, which is in relation to this long-term contract, which is about 15 years, is then going to be an unwinding of those upfront payments. So yes, there is R1 billion outflow, but it's netting off a payment from Google last

year and the portion that they've paid now. So, it's not a significantly new thing. It's nothing of what has already started a year ago. So, that is the Google transaction story.

Serame Taukobong

The lower staff costs that you see in Gyro. Presh, greetings. As part of the Swiftnet transaction, the trigger was to divisionalised Gyro. So, the staff in Gyro then have been absorbed in the group and some have then been moved across various divisions. So, the lower staff cost then reflects the members of staff that are attending to the Swiftnet transaction. So, those are the guys that then are still running the towers operation. So, that's why you see the lower number of staff that remain in Gyro. And the R160 million other income is from property sales. Got that, Presh?

Preshendran Odayar

Thanks. Yeah. Thanks very much for both of those explanations as well. I think a lot of investors are just getting worried about this R1 billion outflow, but I think I also got the gist of it. I also remember it being a timing issue. So, well done keeping your gearing strong even though you [break in audio]. Thanks.

Operator

The next question we have is from Madi Singh of HSBC. Please go ahead.

Madhvendra Singh

Yes, hi. Thanks for taking my question. I have two questions. The first question is on your plans around dividends. Given such a strong performance, if you could share what is your current thinking and by when do you think you can start paying dividends again, as well as in terms of magnitude? How should we think about that? And the second question is a very short follow-up. I think I missed that in the morning, but if you could share what is your current network capacity utilisation on average on your mobile network? Data network. Thanks.

Nonkululeko Dlamini

Yes, thank you. We touched on this a bit earlier. So, we are looking at a dividend policy that would have been approved and announced by the board in March 2024. And I think it's very clear and crisp in terms of how the dividend would be calculated, which we said would be 30% to 40% of the free cash flows. And I think what is to be noted on the dividend policy is that, at the time of getting to that point, the dividend policy as it stands, the board will have to reflect on the free cash flow at that point in time and take a decision.

With regard to the available cash facilities and how we are looking at the process we're going through to close out on the Swiftnet transaction, you may recall that when we issued the secular, we were very clearly saying our priority is to reduce debt and the gearing in the balance sheet. And we are still steadfast on basically making sure that we continue on that journey to reduce the debt on the balance sheet.

The second element, we did say that we would like to ensure that, where there are capital requirements, we prioritise that as well, after we are comfortable that the balance sheet is well resilient and leveraged in the level that is comfortable. We have not changed that position, and the dividend policy will be applied depending on the position when we get to the

financial year. And I think just to also indicate we do not have an interim dividend position in terms of our policy. We've committed to the dividend at year-end once all the assessments have been made with the priorities as I've indicated of reducing debt, capex as a priority, and the board would then have to decide at that point.

Serame Taukobong

Thanks. And in terms of your network capacity question, maybe I should actually answer it more extensively. So, I think we should look at the network in three elements. So, from a RAN perspective, we'll take you back to pre-auction, especially with the temporary spectrum that we were allocated. So, we gave the mobile team then additional topics where they pre-invested in their RAN capacity. And we then got the auction and the spectrum in the right investment that we did. Which means that not only did we build up for the sub-1 gig, which we never had, plus also capacity for the 2300 that we had. And we have successfully deployed that sub-1 gate to build the end capacity on the RAN.

Equally, we've always mentioned to the market that over 75% of our RAN has fibre in terms of backhaul, which is quite key for carrying that data capacity that we have. And we are also continually investing in our core upgrades to manage then the data demand. So, that is the three key elements to ensure that we've got the capacity required to carry the data. I hope that answers you.

Madhvendra Singh

It does. It helps understand the context, But I was still wondering if you think about your own sites and given the combination of your fibre to both sites, would you say 50% of the capacity is still free on the radios or 30% or – is there a number you could share on that, on average?

Serame Taukobong

We generally don't – No, we don't disclose the utilisation of that. But we have made the right investments to ensure that. Remember that Telkom Mobile was one of the first networks, for example, to deploy Massive MIMO on our networks. And we continue to deploy such technologies.

Madhvendra Singh

Okay, great. Thank you very much.

Operator

Ladies and gentlemen, just another reminder, if you would like to ask a question, you're welcome to press * and then 1. The next question we have is from Nadim Mohamed of SBG Securities. Please go ahead.

Nadim Mohamed

Good afternoon, Squire, and to the rest of the team. Congrats on the great set of results. Just three questions from my side. Firstly, in terms of mobile data volumes, it definitely seems to be a step up in Q1 and Q2 to about a 26% growth year on year compared to roughly 20% prior to that. Just want to understand if you can give us some clarity as to what's driving that. I would love to understand that.

Secondly, just on your beyond connectivity that you seem to have picked up quite quickly to 7% of operating revenue from mobile. So, I want to understand what are your propositions going forward that you're looking to introduce to your base and do you see that picking up further from here on? And then lastly, I recall in previous conversations that you mentioned that there's a difference in how backhaul is accounted for within your mobile reporting, and that if you were to capitalise that, you'd have much higher margins.

Now, given the expansion of your margins, I assume that on a normalised basis, that margin is now in the mid-30s or even upper 30s, more in line with your peers. And that would be a fantastic achievement, given your scale. I'm just wondering, is your data-led model lend you towards higher efficiencies once you scale up? Would like to understand that. If you can add any kind of that, we'd be appreciative.

Serame Taukobong

Thanks, Nadim. I did miss your second question. Can you just repeat that for me, please?

Nadim Mohamed

Second question is just on your beyond connectivity revenue. I think it is 7% of operating revenue. I want to understand what are the next set of propositions that you're looking at, or how you plan to grow that going forward.

Serame Taukobong

Thank you. So, if you look at the data volumes, Nadim, and thank you for your questions. Data volumes, really, if you look at where the growth is coming from, it mirrors the growth that we see in prepaid. So, in prepaid, that's where a significant portion of the growth is coming from. So, your prepaid growth is also showing growth in prepaid data. And as we've said, it is the migration in 2G to 4G subscribers. As subscribers are moving from 2G to 3G from other competitors, they are finding attractive propositions in what we have in Telkom Mobile.

As I indicated also in my presentation, our data packages go into quite deep segmented propositions from your low daily hourly bundles all the way up to your high value fibre bundles. So, we just don't focus on your high LTE data bundles, but also your smaller denomination, weekly, daily, monthly propositions. And what's been quite attractive, for instance, is your bundle offerings that include even WhatsApp calling, which is what the market uses. So, it is that attractiveness of those price points that drive that growth.

Beyond connectivity revenue, as we had indicated, the team has, for instance, employed people like Randall into Lunga's team, who brings in the skillset of having that intrinsic knowledge of dealing with that rich media space. We have also indicated that we're not going to open up a media company, but rather how do we partner with that rich media space, driving the right propositions. Because it's not just about offering more free data, but the relevant content for the subscribers.

What you're finding is those short-type media content... I call it TokTok. I'm always corrected. TikTok and Facebook and Instagram, all these things that I get wrong. But that's where you're finding the high attractiveness for our customers, and it's having those right packages in that space. And that is where, Nadim, the focus is going to be in that regard. So, if you

look, you're absolutely right that in that treatment of that backhaul and the work that Lunga and the team have done in the efficiencies at the current rate of EBITDA of 27%, yes, if you normalise and treat that backhaul then in the same level as peers, it will get it closer then to the mid-30s in terms of the implied EBITDA margin for mobile. So, your calculation is right, Nadim.

Nadim Mohamed

Thank you. Just a comment on that. Your data-led model, do you think that lends you to better efficiencies than let's say the kind of models that your peers are deploying where they own all the infrastructure? Do you think, for example, there's room to improve on those margins, or do you think they look pretty tough given the relative difference narrowing quite substantially?

Serame Taukobong

I think it's the mix. I certainly must be realistic. If you look at the current levels of the EBITDA margins of our peers, it is still enjoying the benefits of the high margins of 2G voice. Now, that is almost like legacy copper was to us. And as that base starts eroding, I think it will come to the realistic levels of where data kind of margins are. So, I think that's where the market evolution is going to.

Nadim Mohamed

Thank you very much.

Operator

We have a follow-up question from Myuran Rajaratnam of MIBFA. Please go ahead.

Myuran Rajaratnam

Hi, thanks. A couple of clarifications and then a couple of questions. Just a quick clarification for Nonku. When you said 40% of free cash flow, I might have missed it. Is that operating free cash flow in the sense that it's from your operations rather than any windfall like property transactions included in there or not?

Nonkululeko Dlamini

So, the free cash flow that we look at is inclusive of things like your sale of property because it's a continuous journey we are on. If I just look at the property part of our business, we will continue to consolidate for quite an extended time. But if you look at other elements like your investing activities, if you like, or cash flow from selling the likes of, let's assume, the Swiftnet transaction, that is not part of our free cash flow calculation.

Myuran Rajaratnam

Sure. Thank you. Then a question to Serame. You mentioned Massive MIMO being switched on. You've given us that 75% of your RANs have connection to fibre. What percentage of your sites are switched on to Massive MIMO at the moment? Can you give us a sense? Is it 50%? Is it 30%?

Serame Taukobong

Now, what I'll say, Maran, is that we were one of the first operators to switch on, to deploy Massive MIMO. So, we've been deploying Massive MIMO since it was launched into the market.

Myuran Rajaratnam

Right, and is it across the network? Is it part of the network? Is it only in like built up areas? I just want to get a sense of that.

Serame Taukobong

It's across the network. So, it will be deployed where Lebo and the team see the high concentration and the need for it. I can't give you exact number of size or not, but I'll make that available for you, squire.

Myuran Rajaratnam

Thank you. And the last one is a question. Your big peers are growing service revenue at 1% to 2% in South Africa, and you're growing it at 10%. Is it fair to say you're winning market share? And my question is specifically, do you think you're winning market share across the board or from one particular player? Or is it just your propositions are just appealing across the board? Because you seem to be winning good quality customers. Is that also a fair statement to make, given your ARPU's are not diluting like we saw with Vodacom last year when they put on a lot of subscribers and washed it out again?

Serame Taukobong

Yeah, I think if you may allow me to, Myuran, I'd like to change an answer to say we like to look at revenue share. And I actually want to move us from the washing machine of SIM market share to revenue share, because your basis is right. It's about the 10% growth in revenue share. And that's the key thing for us and where I'd like us to be constantly measured in terms of our growth in service revenue, particularly driven by data revenue growth, because I think that's where the long-term view of this market is going to be. It's about share of data revenue, and we are growing equally from both segments.

And the opportunity that lies for us is there is still quite a significant 2G, 3G base across both operators, whereas we have almost negligible 2G base. And where the market is evolving, as it naturally would, is customers, as they grow from 2G to 4G, they are looking for a proposition that makes sense for them. And I think Telkom Mobile has built such a proposition.

Now, those of you, like yourself who have been in the industry for a long time, know that when a customer moves from 2G to 3G, empirically the output almost doubles or triples because customers start using WhatsApp and Facebook and social media, etc. And we've built that proposition that's attractive for those 2G subscribers. So, that's where we're going.

Myuran Rajaratnam

Right, and last question. Are you seeing competition in the fixed wireless access space? Because some of your peers are monetising the spectrum they won and are starting to show some propositions in the market. So, how are you thinking about that? What's the market dynamics there? Thank you. That's it.

Serame Taukobong

Well, there is competition. And I will also remind the audience that when spectrum was released, there was market expectation that we would see fierce competition in that regard. And we've always maintained that. One had a look at the context of the fact that we were complementing the spectrum that we acquired with sub-1 gig. Whereas our competition, even above the rather large amounts of money they spend to acquire that spectrum, had to further then invest in the infrastructure to support that spectrum, number one.

Number two, if you look at the price points where they were charging in data, it was a significant drop for them to come to match us. So, where there's been fierce competition in that regard, we have not followed in price. We followed in value. That to match the price points, we've made sure that we keep the same nominal price point, but offer our customers more value, which is where they've not been able to compete. So, that's how we've managed to keep the price differential and maintain our customers.

Myuran Rajaratnam

Well done. Thank you so much and keep up the good work, guys. Great performance. Ciao.

Serame Taukobong

Thank you kindly, squire.

Operator

The next question we have is a follow-up question from Preshendran Odayar of Nedbank. Please go ahead.

Preshendran Odayar

Yeah, thanks guys. Just to follow up from Nadim's question on the margins. You guys did well to achieve your 25% margin before the end of FY25. And I know you did allude to the fact that you don't have much 2G subscribers. I think all your 2G subscribers roam on the other networks. But where is there, or should I rather ask, is there still room for margin expansion beyond this 25%? You know, does it normalise back to 25%? Some sort of medium term guidance for this. Because your competitors, they're not really growing much on their top line, but they still holding firm to their mid to high 30% margin range. If you can just share some colour on what you guys are targeting now beyond the 25% by 2025 margin.

Serame Taukobong

Yeah, I think, Presh, if Hasnain was in the room, he must probably be putting his light weight quite on my chest. If I look at the guidance, I mean, 25% to 2025 was a firm target for him. And I think what's important is, in the second half of the year, obviously we know how the seasonality of the market proceeds. And we've got to cut the guys some slack in terms of them making sure that they do the right intrinsics and investments in their business.

I think in the range of where their ambitions are to be, in the mark of between 26% to 28% would be a good benchmark for them to aim to in the next two to three years. And really making sure that we've got the right efficiencies in the market and the right expansion. I think if we look at where they want to go, particularly in expanding the digital ambitions in there, we need to invest in the brand.

A key thing for us is balancing acquisition with retention and how they actually continue to make sure that growing that ARPU and maintaining that prepaid ARPU above that R61 level is going to require them to be investing more in retention as well to get them within that ballpark.

Preshendran Odayar

No, thanks. Thanks very much, Serame. Well done. A good set of numbers you guys printed.

Serame Taukobong

Thank you kindly, Presh.

Operator

At this moment we have no further questions on the conference call and I would like to hand back to Serame if there are any closing remarks.

Serame Taukobong

Thank you kindly. I think as we mentioned in our presentation, we are on a journey. We don't claim that we have landed. This is an early update of where we need to go. Not all the intrinsics are in place, but we firmly believe that we've got a strong team operating and believing in the spirit of One Telkom. We are certainly focused on execution. We are certainly focused on ensuring that our say-do ratio is significantly improved. And we look forward and are quite appreciative of your continuous support. And we will chat to you in our next call. Thank you and have a wonderful day onwards.

Operator

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

END OF TRANSCRIPT