Telkom SA SOC Ltd
(Registration Number 1991/005476/30)
JSE share code: TKG
JSE bond code: BITEL
ISIN: ZAE000044897
(Telkom, the company or the Group)

Group Interim Results for the six months ended 30 September 2022

Group salient features

- Revenue marginally down by 0.7% to R21 150 million
- EBITDA down 17.3% with EBITDA margin at 23.4%
- HEPS and BEPS down 51.9% and 52.5% to 137.2 and 131.6 cents per share respectively
- IT revenue up 16.5% to R 3 119 million
- Mobile revenue up slightly to R10 713 million
- Mobile customer base up 10.9% to 18.0 million
- FTTH connectivity rate at 46.2%

The period was characterised by strained economic conditions placing consumers under pressure and an intensely competitive landscape. Group performance suffered under a sluggish economy, increasing electricity and fuel prices, rising interest rates cycle, and high unemployment, which constrained and impacted levels of consumer spending.

As competition intensified in the mobile sector, we continued to innovate to protect Telkom's value proposition in the market. We saw good growth in our mobile subscribers, sustained the growth trajectory in the fibre market, and corporates revived spending on their Information Technology (IT) infrastructure. However, growth was impacted by customer recharges returning to pre-COVID-19 levels.

We continued to pursue our migration strategy and managed the transition further from old to new technologies. However, this migration impacted our revenue growth and overall profitability.

Performance overview

Notwithstanding the challenging operating environment that persisted during the period, revenue was stable at R21 150 million driven by good traffic growth, which largely offset the impact of legacy product migration. Group EBITDA decreased by 17.3% to R4 942 million, with EBITDA margin contracting by 4.7 percentage points (ppts) to 23.4%. This was due to limited top-line performance resulting from legacy revenue declines and pressures on our cost base. Direct costs increased, driven by materially higher handset and equipment costs. While the rest of the operating costs were well-managed, energy costs increased significantly due to the sustained load shedding during the period. This resulted in an increased cost base. Performance was boosted by lower foreign exchange and fair value movements and tax expenses compared to the prior period. Earnings were negatively impacted resulting in HEPS and BEPS decreasing by 51.9% and 52.5%, respectively.

Group service revenue under pressure

Group revenue declined marginally by 0.7% to R21 150 million, driven by a decrease in fixed, mobile and IT service revenue due to strained economic conditions and the decline in the legacy fixed business as customers migrate to new technologies such as fibre and LTE. This was offset by an increase in mobile handset and IT hardware and software sales. These sales are at lower margins and in line with the mobile strategy to drive post-paid annuity revenue.

EBITDA impacted by higher handset costs and operational expenses

Group EBITDA is lower at R4 942 million, and the EBITDA margin contracted by 4.7 ppts to 23.4%. This was attributable to a 31.4% increase in our cost of handsets, equipment, software and directories, following higher mobile handset sales of 19.7% and the increase of 73.1% in IT hardware and software revenue.

Opex increased by 5.0% year-on-year despite an average Group-wide salary increase of 6.0%, which was effective from 1 April 2022 and is lower than CPI of 7.8%.

Service fees increased 21.0% driven by a significant increase in diesel expenses, resulting from increased load shedding, and higher advisory fees incurred, mainly attributable to mergers and acquisition-related transactions and key strategic projects.

Mobile cost to serve, such as distribution channel cost was optimised despite the increase in costs associated with targeting the post-paid market. Optimised roaming costs further contributed to an improved cost to serve as we maintain stringent roaming traffic thresholds and migrate traffic to our own network, enabled by the ongoing network investment.

Openserve's stabilisation path continued as customers migrated from legacy to next generation technologies. In the period under review, revenue declined by 4.3% despite a pleasing 10.8% growth from next-generation revenue. This was underpinned by growth in high-capacity links for carriers, an increase in demand for fibre services and growth in enterprise connectivity. Today, more than 65% of revenue is derived from next-generation products and services. However, a pricing and margin gap remains between the new business and legacy businesses. The accelerated decline during the period in legacy fixed business limited overall performance. Openserve continued with its growth trajectory in the fibre market, increasing homes passed with fibre by 35.8% and homes connected with fibre by 33.7%. This aligns with the strategy to accelerate the fibre to the home (FTTH) footprint while simultaneously focusing on connecting homes. The current homes connected ratio is 46.2%.

The Mobile business continues to drive growth in Telkom Consumer. Total Mobile revenue grew marginally by 0.5% as the product mix evolved towards longer customer post-paid contracts. This was achieved against the backdrop of intensely competitive markets in a challenging economic environment. As the overall macro-economic constraints materialise, the pre-paid surge has slowed as the share of wallet reduced. We grew our pre-paid subscriber base by 10.7% to 15.2 million. In the post-paid market, the post-paid base increased by 11.7% to 2.9 million while the ARPU reduced to R206. The legacy fixed-line business remains under pressure due to migration from traditional fixed-voice to newer technologies.

We refreshed our post-paid wireless broadband portfolio to significantly improve our value offering in the capped and unlimited plans. We were rewarded as our mobile broadband subscriber base increased by 3.7% to 11.0 million customers.

We remain encouraged by the continuing growth in our non-connectivity/application services which saw double-digit growth in the period under review.

BCX saw a recovery in the period under review as it combated and managed global supply chain constraints. BCX's efforts resulted in 13.7% revenue growth in the IT business for hardware and software solutions as corporates began investing in IT again, following a muted two-and-a-half-year period since the beginning of the pandemic. With rising activity in the market, there are renewed cross-selling opportunities for integrated solutions by BCX. The Converged Communication business was challenged with ongoing legacy to next-generation migrations. Overall revenue grew marginally by 0.8%, mainly boosted by the IT segment. This improvement in performance signals a positive outlook for the remainder of the financial year.

Swiftnet, our masts and towers business, decreased revenue by 2.1% to R660 million, driven by the impact of continued focus on modernisation from our mobile network operator (MNO) customers. We expect a continuation of modernisation over the next year, coupled with the deployment of new base station sites as the MNOs deploy their respective newly acquired permanent spectrum allocations. In the current year, the number of productive sites increased by 3.0% to 3 945. Swiftnet's profitability was impacted by once-off costs and the change in direct property cost allocation methodology.

FCF under pressure mainly due to the impact of handset sales on working capital management

We generated negative FCF of R1 887 million, 124.9% lower than the comparative period.

Cash generated from operations decreased by R1 682 million compared to H1 FY2022 primarily due to the R1 031 million decline in profit before taxation and the R860 million deterioration in cash collections. The deterioration in cash is driven by the increase in trade receivables and contract debtors due to higher post-paid mobile handset sales. The collections derived from mobile handset sales are deferred over a 24- or 36-month contract while the cost of sale is recorded immediately. This was partially offset by a 16.1% decrease in cash paid for capex.

Value unlock journey and strategy update

The Board remains committed to the value unlock strategy, which is premised on Telkom's market capitalisation not representing its intrinsic value. Our strategic approach is to affirm the valuation of these businesses and their contribution to the valuation of Telkom while ensuring long-term sustainable growth for the Group.

Progress was made in this regard in three areas:

The Board gave an in-principle approval to affirm and realise the value of its investment in Swiftnet partially or in full. Management is exploring various options of realising the value of the mast and towers business and will update the market in due course.

Openserve is now a legally separated 100% subsidiary of Telkom, effective 1 September 2022. This presents the Group with opportunities to unlock value through aligned partnerships.

In line with the Group's drive to invest in future growth, BCX entered into a strategic partnership with Alibaba Cloud to drive digitalisation locally and provide a wide range of cloud computing products and services to the continent on an exclusive basis. We expect this business to start contributing to revenue in FY2024 and ramp up in the medium term as it enhances its IT business offering.

We are fully committed to executing our broadband-led strategy as it is the backbone of our Group strategy. Telkom is investing in 5G infrastructure assets. We currently have more than 136 active 5G sites in Gauteng, Western Cape, Eastern Cape and KwaZulu-Natal. Our Mobile business officially launched its 5G network, followed by its first 5G fixed wireless propositions to consumers. This next-generation network will open new opportunities for smart cities, healthcare, manufacturing and other various industries. Mobile propositions will become available as the 5G device ecosystem matures. Swiftnet successfully launched its first 5G outdoor Distribution Antenna System (oDAS) Small Cell sites. This will be the basis for future site deployments in support of our customers' 5G rollout plans.

Our infrastructure businesses, Openserve and Swiftnet are well-positioned to capture these opportunities in rolling out infrastructure as the industry requires masts, towers and fibre backhaul to connect to base stations for this new technology.

In some of our businesses, we want to strengthen scale and capability to drive growth. Here, we are exploring local and international partnerships.

Regulatory developments

ICASA published its findings on its review on call termination rates. ICASA has concluded that only new entrants qualify for asymmetric mobile termination rates and that the 20% threshold to qualify for termination asymmetry be removed. Telkom has filed a court application to review and set aside the determinations in ICASA's findings document arguing that the conditions upon which asymmetry was conceived persist, that the findings are irrational and that they do not promote competition. ICASA and MTN are opposing Telkom's application.

Outlook

A solid financial framework is vital to support the Group strategy and deliver sustainable shareholder returns. In line with our financial framework, we prioritised investing in working capital across our business units to serve the growing customer base, evolving product demand trends and securing sales despite ongoing global supply chain constraints. We also continued to invest capital in growth areas.

The Mobile business has shown good and continued subscriber growth as it enhanced its broadband offering, entrenching its market position. We expect this momentum to continue for the rest of the financial year along with a focus on extending selling channels, optimising the mix between pre- and postpaid customers and expanding its RAN network to reduce roaming costs. Openserve will focus on monetising new products and actively manage costs to improve margins - decommissioning legacy assets plus extend its energy initiatives to reduce the impact of load shedding. BCX continues to gain traction in its IT business but remains challenged by increased competition in its Converged Communications. It will continue managing its costs closely to maintain its margin for the year. The Gyro group will benefit from Swiftnet's continued build of towers to increase its productive portfolio. This, coupled with expected lease renewals and incremental tenancies will maintain Swiftnet's healthy margins for the remainder of the year.

We expect to continue investing in the business with a capex to revenue ratio of between 16% to 18% (excluding spectrum) for the year. The net debt to EBITDA ratio of 1.7x is impacted by investments in this working capital cycle.

Given the material increases in the cost of sales for Telkom Mobile, the accelerated decline of the legacy business at Openserve, BCX and Consumer, plus the impact of load shedding, we are revising our guidance to the market. In the medium-term, we expect revenue and EBITDA to grow at low to mid single digit percentages.*

Returning cash to shareholders remains a key element of our capital allocation framework. Telkom is in the final year of the three-year dividend policy suspension period. The Board remains committed to reinstating the dividend policy at the end of FY2023 and is reviewing the policy.

Telkom aims to continue to create value and generate sustainable positive free cash flow to reward shareholders in the medium term once our working capital cycle stabilises in line with new demand patterns and evolving customer requirements.

Financial performance	Reviewed September 2022 Rm	Reviewed September 2021 Rm	Variance %
Gross operating revenue	21 150	21 292	(0.7)
EBITDA	4 942	5 978	(17.3)
EBITDA margin (%)	23.4	28.1	(4.7)
Capex	3 689	3 610	2.2
Free cash flow (FCF)	(1 887)	(839)	(124.9)
BEPS (cents)	131.6	276.8	(52.5)
HEPS (cents)	137.2	285.5	(51.9)
Net debt to EBITDA (times)	1.7	1.1	0.6
Interim dividend (cents)	-	-	-

Sello Moloko
Chairman

Serame Taukobong
Group Chief Executive Officer

Dirk Reyneke
Group Chief Financial Officer

23 November 2022

Sponsor
Nedbank Corporate and Investment Banking, a division of Nedbank Limited

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 Wednesday, 23 November 2022 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 report, is available on the company's website at: https://www.telkom.co.za/ir/financial/financial-results-2023.shtml

and on the JSE's website at: https://senspdf.jse.co.za/documents/2022/jse/isse/TKG/ie2022.pdf

Copies of the full announcement and the condensed consolidated interim financial statements for the period ended 30 September 2022 are available for inspection at the company's registered address and the offices of the JSE sponsor (Nedbank Corporate and Investment Banking, a division of Nedbank Limited) during office hours at no charge to shareholders. Copies of the Telkom interim financial statements for the period ended 30 September 2022 may be requested from Ayanda Ceba at cebaac@telkom.co.za

* The guidance in this outlook has not been reviewed or reported on by Telkom's joint independent external auditors.

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