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Telkom: state might not sell

Communications minister wants to hang on to stake while the board sees proposed offer as far below market value

By THABISO MOCHIKO

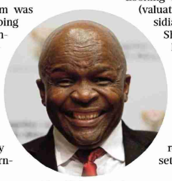
● The minister overseeing the government's sizeable equity stake in Telkom is not in favour of the state relinquishing or diluting its 40% shareholding in the telecoms company.

Business Times has learned from numerous sources in and outside of government that communications & digital technologies minister Mondli Gungubele is opposed to government reducing its stake in Telkom. The Mail & Guardian also reported Gungubele as saying he would be worried if the government were to support a majority stake elsewhere.

He told the paper Telkom was still a strategic entity helping South Africa leverage connectivity on the African continent.

"As far as I'm concerned, Telkom is still strategic to the government's programme," he said.

It is not clear if Gungubele's views are shared by cabinet which has a final say on the future of the government's Telkom shareholding.



Mondli Gungubele

But his stance could be a serious blow to a consortium led by former Telkom CEO Sipho Maseko, which is vying for control. Maseko's AfriFund and its international partner, Axian Telecoms of Madagascar, have offered Telkom shareholders R46 a share for a 35% stake in the company, in a bid worth R12bn. The consortium has the Public Investment Corporation – which owns 14.1% of Telkom – in its corner, and was hoping to convince government to dilute its shareholding.

But the Telkom board has rejected the R46 offer as too low. The consortium has tabled a revised offer that is not materially different from the initial one. Should it fail, it will engage shareholders directly.

Telkom CEO Serame Taukobong told Business Times the company will not be entertaining offers below R60. Telkom's share price was trading at R33 by Friday, but the board believes a market valuation of around R17bn does not reflect the company's true intrinsic value.

Taukobong said "the market says we see an appetite for a transaction for Telkom but it has to be at a credible" price.

He said the company was "open to any conversations and any partnerships but will not compromise on the Telkom value position – whatever value has to be reflected on what we think the Telkom price should be at".

Mobile giant MTN, which walked away from a bid for Telkom last year after another network, Rain, also expressed interest, is said to be preparing another bid.

A source close to the Maseko consortium said the team will engage the Telkom board on the valuation, but conceded that there can't be a deal without government participation.

Contacted for comment, Maseko said: "We don't think it's appropriate to conduct negotiations through the media. We are respectful of the next steps in the process which would be to engage with the independent board, conduct due diligence, listen to shareholders, and arrive at terms that would be fair and acceptable to shareholders."

Philip Short, senior equity analyst at Flagship Asset Management, said valuations are always going to be subjective and there are several ways to value a company like Telkom, like discounted cash flow, price-to-equity ratio and net asset value (NAV).

"One should also consider what the value of the assets is in somebody else's hands, which is why Telkom finds itself subject to takeover talks," he said.

Looking at the sum of the parts (valuation) for the different subsidiaries minus net debt, Short says Telkom is worth R62 per share – using subjective multiples on the latest earnings before interest, depreciation and armotisation (Ebidta) numbers per business segment. "I am cognisant that they have recently impaired their assets such that NAV has declined from R68 to R47," he said.

Short said government would sell if certain terms were agreed upon. A major one would be that whoever buys Telkom, and more specifically its fibre business Openserve, continues to service areas that do not make economic sense.

For example, having a copper and/or fibre network running to certain peri-urban areas in provinces such as the Eastern Cape or Limpopo might be a loss-making exercise but the government sees itself as providing services for those areas and is happy to do so at a loss. If they do sell to MTN, for example, it would come with some strings attached, like servicing these areas and perhaps a mandate to roll fibre out to these types of areas, Short said.

Peter Takaendesa, head of equity at Mergence Investment Managers, said some of the proposals for Telkom transactions would not require all shareholders to sell all of their shares.

"It is still possible that those transactions that are looking to acquire minority stakes in Telkom can continue as long as those investors are confident they will be able to work with the government as a large shareholder in Telkom. The government may be interested in keeping Telkom as it is or it could be that it is comfortable to remain a

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Declining revenue has seen Telkom seeking partnerships to accelerate its recovery strategy. Picture: Siphiwe Sebeko/Reuters

Gungubele resists Telkom sell-off

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large shareholder in any post-transaction structure of Telkom. It's very difficult to speculate without full information."

Takaendesa said if it were to become official that government won't sell its large stake in Telkom, this would eliminate a number of suitors.

At the financial results presentation, Taukobong insisted Telkom "has the right levels of liquidity and ... did not need a knight in shining armour."

He said Telkom would remain a strong infrastructure company, and on fibre "nobody can touch us".

It has received other offers for Openserve whose fibre connection has reached just over 1-million houses.

Telkom will also dispose of its tower business Swiftnet in the coming weeks.

Taukobong said the disposal of Swifnet will enhance Telkom's valuation and boost free cashflow. "The balance sheet [will] be quite strong. The value unlock in Swiftnet will boost the group."

An outright sale could bring in R6bn that can be used to reduce debt and give Telkom some breathing room, said Short. "But on its own it is not enough to bring meaningful change, operationally."

Telkom, which also owns technology business BCX and runs mobile network subsidiary Telkom Mobile, reported a R10bn loss dragged by declining consumer spending, high interest rates and inflation. The company also cited elevated competition and high load-shedding which diminishes network availability and results in higher operating costs.

"These factors are likely to persist over the next year, requiring a strong focus by management on cost efficiency and cash generation which has also been very weak," said Aslam Dalvi, portfolio manager for Camissa Asset Management.

Short said Telkom's performance over the last couple of years was disappointing. "The main concern is that they've spent an enormous amount in terms of capital expenditure for very little return. This has resulted in negative free cash flow, no dividend, and missing its own guidance. It's difficult to see Telkom recovering in the medium term other than restructuring its cost base or changing its strategy."

Taukobong said he was confident Telkom's fortunes would improve. "We are going through a transition period and it's going to [take] 18-24 months. In terms of the strategies that the board has approved, we certainly do see bigger opportunities for creating value. We set ourselves to unlock various entities. The big challenge is how do we flip that to value creation, which is what shareholders are looking for."