Conference Call Transcript

11 June 2018

BEE OWNERSHIP TRANSACTION

Operator

Good day ladies and gentlemen and welcome to the Vodacom Group Ltd conference call. Vodacom Group CEO, Shameel Joosub, will host this conference call. During the call the speakers will reference to the transaction documents. These include the presentation which is available on www.vodacom.com under the investor relations section under the heading Yebo Yethu. I will read the forward-looking disclaimer before handing over to Shameel.

This call and related documents set out the salient features of Vodacom's proposed BEE ownership transaction. These statements have not been reviewed or reported on by the group's auditors with respect to the group's financial condition, results of operations and businesses and certain of the group's plans and objectives. In particular such forward-looking statements include statements relating to the group's future performance, future capital expenditures, acquisitions, divestitures, revenues, expenses, financial conditions, dividend policy and future prospects, business and management strategies relating to the expansion and growth of the group, the effects of regulation on the group's businesses by governments in the countries in which it operates, the group's expectations as to the launch and rollout dates of products, services or technologies, expectations regarding the operating environment and market conditions, growth in customers and usage and the rate of dividend growth by the group.

Please note that all participants are currently in listen-only mode and there will be an opportunity for you to ask questions later during the conference. If you should need assistance during the call please signal an operator by pressing star and then zero. Please also note this call is being recorded. I would now like to turn the conference over to Shameel Joosub. Please go ahead, sir.

Shameel Joosub

Thank you. Good day everyone and thank you for joining the call. I'm joined by Till Streichert, our CFO, and Nadya Bhettay, the Chief Officer of Strategy and New Business at Vodacom. As mentioned in the intro we have published a presentation and we have used this presentation as reference during the call. The purpose of the call is to share with you details of the black economic ownership transaction which we announced through a JSE SENS release this morning. We have signed key transaction agreements with our BEE partners including RBH, Thebe, Yebo Yethu and the newly formed staff scheme.

Turning to slide three first. These agreements will see these parties participating in the largest transaction of its kind in the ICT sector with an approximate value of up to R17.5 billion. The transaction is evidence of our continued commitment to transformation in South Africa. It is a truly broad-based deal and by remaining on the BEE exchange on the JSE will continue to give access to new shareholders while giving current shareholders an opportunity to realise value from their original investment. There are still a number of steps that need to be completed including a vote by the shareholders of Yebo Yethu before the conclusion of the transaction. However we expect the transaction to be completed by September 2018.

If we then move on to slide four, slide four gives a quick overview of the scorecard points and BEE levels in the industry at the moment. This reflects the BEE levels as measured by the DTI sector scorecard. Our most recent assessment which was released a week ago rates Vodacom as a level 3 BEE contributor with a contributor score of 110.6, noticeably ahead of our peers. This shows significant improvement from last year's score, reflecting progress made, while the pro forma effects of this deal will see our score increase even further and count towards maintaining our level 3 contributor status.

If I move on to slide five, on slide five we show our guiding principles in setting up the deal and how this will be implemented. We wanted to preserve and ultimate enhance the BEE effective ownership in Vodacom South Africa. Our BEE shareholders have been our partners for ten years, and it was important that the transaction provides a return of capital as well as a more liquid and tradable shareholding going forward. One of our objectives was to minimise the cost to the transaction through an equity contribution from shareholders and third party funding to the deal. Our aim was also to bolster and grow Yebo Yethu. For that the new structure consolidates our BEE shareholding into one single entity, Yebo Yethu, and remains listed and tradable on the BEE exchange.

The shareholding is now at Vodacom Group level which provides exposure to both our South African and international operations including Safaricom. We have ensured that the funding and capital structure remains robust and sustainable in order to ensure Yebo Yethu can deliver similar value in this deal as it will receive from the Vodacom South Africa BEE deal. Importantly the transaction does not require new BEE capital but rather commitment from our BEE partners to reinvest part of the value realised from the existing deal into this new BEE transaction. Given Yebo Yethu is listed on the BEE exchange of the JSE new BEE investors are not precluded from participating in the transaction going forward once finalised. We have also been able to optimise the cost of the transaction to Vodacom Group shareholders as a result of the significant capital commitment from our BEE partners to the new deal and the attractive interest rates on the gearing of the structure.

If we now move on to slide six, the pre-transaction structure, to give you a better sense of the deal let's have as quick look at our pre-transaction structure. We implemented a R7.5 billion broad based BEE deal with RBH, Thebe and Yebo Yethu in 2008 at the Vodacom South Africa level. This 6.25% deal was facilitated through notional vendor financing structure and raised R900 million of capital from the black public and our strategic partners, Thebe and RBH. This transaction has contributed meaningfully to our current effective BEE ownership of 17%. The transaction is scheduled to unwind in October 2018 and hence this new transaction that we are announcing today includes the unwind of this structure. Based on an assumed R152.50 Vodacom Group share price the unwind of the existing Vodacom South Africa structure will deliver approximately R7.5 billion of value to our existing partners. This amounts to 6.7 times the original capital they invested into the deal in 2008 and will therefore be one of the most profitable and successful value realisations of any BEE transaction concluded in South Africa. A portion of this value will be realised through an approximate R3 billion special dividend and the remaining equity committed to the new structure.

If we then move to the next slide, which is the funding of the deal, I will now take you through the funding of the deal. The table on the left-hand side indicates how Yebo Yethu will be raising the R17.5 billion and how these proceeds will be used. Vodacom will provide a 10% discount on the shares acquired in Vodacom Group and contribute R750 million equity contribution for the new employee share scheme. Our current BEE partners, being RBH, Thebe and Yebo Yethu, are committing R4.5 billion of the R7.5 billion realised on the unwind of the Vodacom South Africa BEE deal. Yebo Yethu will raise a further R10.5 billion of funding through an issue of preference shares. This includes third party funding of R5.8 billion and vendor funding of R4.7 billion at preferential rates. Yebo Yethu will then in turn purchase shares in Vodacom Group therefore giving Yebo Yethu shareholders access to the wider South Africa, international and Safaricom operations.

The resulting structure is illustrated on slide eight. Vodacom South Africa becomes fully owned. Shareholding at the Vodacom Group level will be diluted by the additional shares in issue which will be between 5.8% and 6.3% dependant on which price the deal closes at. Yebo Yethu will then become Vodacom Group's third largest shareholder. And finally, all BEE partners are consolidated within a single entity, namely Yebo Yethu. Overall effective black ownership in Vodacom South Africa will be around 20%, improving the beneficial ownership in mandated investments including PIC.

If we then move on to the slide on dividend policy I know all of you will be interested in the effect on the dividend. A policy to pay 90% of headline earnings excluding the Safaricom attributable profits has been reaffirmed by the board. The board however intends to add back the day one non-cash IFRS 2 charge in relation to Yebo Yethu for dividend calculation purposes. Effectively this cost is estimated to be R2.7 billion using a share price of R152.50 on pricing day.

I then move on to the financial effects. The impact of the transaction is reflected in the table on slide ten. I would like to focus on two items here. The first is the middle column where we add back the IFRS 2 charge I was referring to for dividend purposes, so focus on the financial impacts between column A and column B. And secondly focus on the line items showing the diluted earnings and the diluted headline earnings. This takes into account both the effects of the minority shares in South Africa prior to the new deal as well as the effect subsequent to the deal. It is therefore more reflective of a like for like comparison. The net effect on diluted headline earnings is therefore 4.2%. The pro forma effect on the dividend per share in year one as per the scenario is approximately 10.8% when taking into account the share dilution, transaction cost and the costs associated with the employee share option scheme.

The more detailed steps to the transaction are set out in the appendix slide and a circular with more details will be distributed in the next couple of weeks. We are expecting to conclude the transaction by September 2018. That concludes my overview of this proposed landmark transaction, and Till and I are now ready to take your questions.

Operator
Thank you very much sir. Ladies and gentlemen, at this time if you do wish to ask a question please press star and then one on your touchtone phone. If you decide to withdraw your question please press star and then two to remove yourself from the queue. Again if you wish to ask a question please press star and then one now. Our first question is from JP Davids of JP Morgan. Please go ahead.

JP Davids
Good afternoon guys. I've got three questions please. The first one is on IFRS 10 and your intention to consolidate the vehicle. It does mention there that things could change and then it would no longer be consolidated. Maybe if you could help us understand what some of those variables would be, for example paying down certain debt? I'm not sure what would cause it to be deconsolidated. And maybe just finally on that point, can we assume that after ten years when this transaction expires that it would no longer be consolidated? That's question one. It's a nice long duration here of ten years. Can you provide any context or colour around looking at making this a perpetual deal i.e. one that doesn't expire? And then the final question from my side is clearly as you flagged in the presentation, your scorecard is now best in class but it seems there is still further upside on the equity side towards 30%. Why not go the whole hog with this deal and move from 17% to 30%? Thank you.

Shameel Joosub
Okay. Till, do you want to take the first question?

Till Streichert
That's perfect. Let's start on that. JP, similar to the last transaction that we also consolidated this transaction we equally consolidate as we in essence through the structure and through the way we fund it basically have got control over it. But again that is an accounting view in terms of the control. As you rightly say we will need to assess from time to time at every reporting period whether the control principles in IFRS 10 are still met. My expectation is that at the end of the deal, so at the end of the ten year time horizon, in essence the principles of IFRS 10 will not be met anymore and then basically we would deconsolidate the Yebo Yethu investment structure.

Shameel Joosub
Okay. On your second question, the ten year one, the transaction has a ten year funding period but Vodacom has entered into a relationship agreement with Yebo Yethu which caters for the ability for Vodacom to engage with Yebo Yethu from year nine to extend the transaction if both parties agree. I think it's important to note that effectively we are not locking in the shareholders. The fact that the share is listed on the BEE exchanges gives them the flexibility to trade, but that is what locks them in. and the ten years is obviously for them to realise value from the transaction but it is also extendable. In terms of 17% to 30%, JP, it is just cost. I think we can see the costs associated with this deal. Getting to 30% is just too costly to be honest.

JP Davids
Fair enough. Thank you very much for the feedback on all those questions.

Operator
Thank you. The next question is from Jonathan Kennedy-Good of SBG Securities. Please go ahead.

Jonathan Kennedy-Good
Afternoon. Thanks for taking my questions. I just wanted to confirm. I think you mentioned that on a dividend per share basis pro forma the dividend would be down 10.8%. Did I hear correctly on that? So the R8.15 dividend that you paid this year would be more like R7.27 on a pro forma basis.

Till Streichert
So on a pro forma basis you can actually work it out from what we've shown on the HEPS line. The minus 1.8% that we had reported would become indeed a minus 10.8%. So that would be on FY2018 numbers. And that is due to the fact of the share issue and obviously a portion of the IFRS 2 charge that we would not add back in year one and the transaction cost.

Jonathan Kennedy-Good
Thank you.

Operator
Thank you very much. Is that all you need to ask, Jonathan?

Jonathan Kennedy-Good
Yes, that's all. Thank you.

Operator

Thank you very much. Ladies and gentlemen, again if you wish to ask a question please press star and then one. Our next question is from Myuran Rajaratnam of MIBFA. Please go ahead.

Myuran Rajaratnam
Hi guys. Thanks for taking the questions. I've got a couple of questions. Just to start off with, if I understand the deal properly – and please correct me because I'm slow on the uptake on these things – there is going to be additional shares issued which will receive dividends because those dividends are needed to pay off external funding as well. Is that correct?

Shameel Joosub
That's correct.

Myuran Rajaratnam
Okay. This will be the 136 million treasury shares that you talk about on page ten?

Till Streichert
No, that's not correct. In essence at an assumed share price of R152.50 that Shameel has been quoting throughout his explanation that would be about 114 million shares. Remember we do have already some shares in treasury and some SSP shares. So if you look at the left-hand column in the pro forma you can see the starting point. And then basically if you work yourself through the second and third column you can see the additional 114 million shares added.

Myuran Rajaratnam
Thanks. And just to understand it a little bit further, your dividend yield is about 6%. So that will be used to pay the structure, the financing in the structure of 68% to 70% of prime. The sense I get is that the dividend will be used to pay off the interest, so it is actually purely the share price performance that will be the upside for the BEE guys. Is that pretty much until the dividend growth is high enough to pay off the guys, interest as well as their debt. Is that right? At the moment it looks like the amount that you pay as dividends for the structure would just about be covered by what is owed by the structure on its debt.

Shameel Joosub
So the benefit that you have is obviously the share price growth is paramount in terms of deriving value from the deal. And the dividend flow, the dividend will be used to service the debt. But as the company grows the dividend grows and obviously you've got the gap between the debt that is in the structure and the dividends. Or you will end up paying off a little bit faster if anything.

Till Streichert
But let me perhaps come from another angle. Shameel has explained that the total deal value is in essence R7.5 billion around about to the BEE shareholders, which is basically about 6.7 times their initial investment. Remember the deal is structured as basically a flip up of the investment that is sitting in the current deal. And then there is a bit of a top up which makes our effective shareholding going from 17% to 20%. So the deal value for our BEE partners is the R7.5 billion. that has been valued and you can see that in the announcement described and explained using a Monte Carlo simulation to forecast the ten year expected deal value minus what they give up because it is a flip up. So that basically is the value that you generate on a net basis through the flip up and the top up.

Myuran Rajaratnam
Great. Thank you so much.

Operator

Thank you. Ladies and gentlemen, again if you wish to ask a question please press star and then one. We have a follow-up question from JP Davids. Please go ahead.

JP Davids
Hey guys. I just wanted to understand the sensitivity of the dilution etc. to the share price. Obviously you based it on the 60 day VWAP of R152. If the share price moves 5% higher or lower are you able to give any EPS sensitivity around that type of share price move? Thank you.

Till Streichert
I don't have it at my fingertips but it is fairly mechanical. Look, we certainly can come back to that question, but I don't have that at my fingertips. But as I say it is mechanical. We can certainly provide that.

JP Davids
Thanks Till.

Operator
The next question is from Peter Takaendesa of Mergence. Please go ahead.

Peter Takaendesa
Hi. Good afternoon. Shameel, could I just ask, I think the presentation is a bit clearer. It says Vodacom SA BEE effective ownership of 20%. I think there was a bit of a confusion. Unless I am missing it here the original long document refers to 20% for the group. Could you just confirm that please?

Shameel Joosub
It's 20% at the SA…

Peter Takaendesa
At the SA level.

Shameel Joosub
Sorry, it's 20% at the group level.

Peter Takaendesa
Okay. So if I can just ask, Shameel, my understanding is that the requirement for spectrum and all of that is 30% ownership. So what is your thinking on this?

Shameel Joosub
So it's debatable whether there is a 30% ownership requirement because basically the codes refer to comply to the ICT sector codes. And the regulator is currently going through a process of providing further clarity on the actual requirements, because the requirement basically is 30% or level four on the BEE codes. We are a level three contributor as you can see so we should quality for spectrum.

Peter Takaendesa
Okay. All right. Thank you.

Shameel Joosub
Sorry, just to be clear, the 20% is at the South African level. So it flows through to 20% at the South African level.

Peter Takaendesa
Okay, that makes sense now. Okay, thank you.

Operator
Thank you. The next question is from Madhvendra Singh of Morgan Stanley. Please go ahead.

Madhvendra Singh
Yes, hi. Thanks for the call. Just a couple of clarifications. Just on the dividend you said pro forma basis it will be 10.8% impact on FY18 dividend. Is that inclusive of all the charges including the one-off ESOP charge of R2.7 billion? And secondly on the minority interest related to the previous Yebo Yethu deal. In the current deal that would actually go away. I'm just wondering what is the positive impact if any from that, and whether the table which you have shown of HEPS impact of 4.2% already incorporates that positive impact of not having minority interest from your vehicle.

Till Streichert
On the dividend per share what Shameel has been quoting as a number assumes already a consistent application of what we said as the intended dividend policy going forward. So it is adding back the R2.7 billion day one non-recurring IFRS 2 charge so that it is comparable.

Madhvendra Singh
Okay.

Till Streichert
The second question on the minority part, the way to look at it is in the previous deal from an ownership point of view obviously the minorities had the 6.25% of Vodacom South Africa. In the flip up deal now the legal ownership is with Vodacom Group and gets to 100%. However also in the previous deal basically from an accounting point of view since we controlled the deal and consolidated it we took basically 100% of the earnings and the dividend into account. And only at the time of unwinding, so when the deal crystallises in October this year, this 6.25% on SA level would have moved into the hands of the minority shareholders. Hence in essence we always had 100% of the earnings and the dividends basically previously, and it gets now basically flipped up and rolled forward. So all of this is in the numbers that you can see there.

Madhvendra Singh
Okay, thank you. Sounds Good.

Operator
Thank you very much. Our next question is then from Preshendran Odayar of Citi. Please go ahead.

Preshendran Odayar
How is it, guys? I've just got two quick questions. One is the Yebo Yethu shareholder vote on this. The way I understood it is these Yebo Yethu shareholders when they took out the deal in 2008 were thinking they would get Vodacom SA shares at the end of the deal. Obviously Vodacom wasn't listed at the time. Neither was Vodacom SA. What is the likelihood that these guys would vote against this new deal where they flip up? Is there an option where they could potentially say we want Vodacom Group or Vodacom SA shares? Secondly, what is the black ownership at the group level, if you can disclose that to us?

Shameel Joosub

Okay. So just to be clear we've already got irrevocables from Thebe, RBH, Yebo Yethu current scheme, Yebo Yethu new scheme and so on. And that takes us to over 50% of the irrevocables already having been achieved. We need to get to 75% approval. You can never say for sure, but we don't foresee any risk because of the level of benefit that is flowing to the shareholders to the tune of R7.5 billion split between the dividend and shares. In terms of the group level the BEE percentage at the group level will be 17% or 18% and it flows through to about 20% at South African level.

Preshendran Odayar
Okay. Thanks very much, Shameel.

Operator
Thank you. The next question then is from Ziyad Joosub of HSBC. Please go ahead.

Ziyad Joosub
Sorry to harp on about this, but maybe if you could just clarify. Of the R4.2 billion facilitation fees R2.7 billion will be reversed out and not form part of the headline earnings that you will use to pay out the dividend. The remaining R1.7 billion [inaudible segment] next year forecast.

Till Streichert
Okay. Let me just run through that again. You were a little bit interrupted, but I think I got your question. Out of the R4.2 billion IFRS 2 charge you have rightly highlighted we are adding back in this fiscal year for dividend calculation purposes the non-recurring share based payment charge of R2.7 billion. So that you can give a tick. That is what we are showing you in the pro forma and you will see in the circular. The recurring share based payment of R1.5 billion which is the balance is basically spread over a five year period and relates to the Vodacom ESOP. So that is the Employee Share Trust. That we are not adding back. That is basically a staff expenditure spread over a five year period, not entirely linearly. It is a little bit off, but almost. And that is a cost that is much more to be seen as a black economic retention empowerment scheme which like in the previous deal that we had before sits on your normal staff expenditure line and flows into your earnings.

Ziyad Joosub
Okay, understood. Okay, sorry about that. So that is roughly a R300 million per annum cost.

Till Streichert
Roughly, roughly. Precisely.

Ziyad Joosub
Okay. Thanks so much. Thank you.

Operator
Thank you. Ladies and gentlemen, a reminder if you wish to ask a question please press star and then one now. Sir, it would appear that we have no further questions. Do you have any closing comments?

Till Streichert
Chris, perhaps I can just add one comment from my side and then hand over to Shameel. Obviously our two goals were to create an attractive deal to our BEE shareholders. And I think Shameel has given the salient features and the highlights of that. At the same time our objective was to keep the deal to all our other shareholders as efficient as possible. And I think I just would like to give you two or three proof points for that. I think you need to look at transaction cost, the facilitation cost and the

financing cost then. If you just look at the facilitation cost, the R4.2 billion charge that we've got in there, and you compare it to the deal size of R17.5 billion that is around 25% that we have been quoting or the 1.7% of our market cap. And if you look at the last 15 deals that have been done since 2010 in South Africa the benchmark, what is for us 25%, has been in the last 15 deals at north of 30%. So I think that's a proof point of efficiency in terms of facilitation cost. Financing cost we have cleared the preference share funding with our commercial banks at 68% of prime. That in itself is a good achievement for the entire deal. And equally if you benchmark the transaction cost, which we have indicated was R157 million, and you look at the deal size and you compare it to deals that have been done in South Africa over the past few years you will equally arrive at the conclusion that this has been a fairly efficient deal. I think these are just the proof points, but also from an efficiency point of view I think we've got a good deal.

Shameel Joosub
Look, I think overall we are quite pleased. To be fair as we've said before every ten years or so there will be a cost that needs to be taken for BEE. And I think the deal has been structured in such a way to minimise the cost but to provide benefits to our existing shareholders. Also I think we managed to minimise the discounts by getting the deal to roll into the other deal. So overall I think a very well structured deal. I also think that this deal has the potential to not be the one in ten year cost because you will get the opportunity to extend it at the end of the ten years. We can't call it evergreen, but essentially it does give you the chance to roll it further. Thank you everyone for joining. If there are any questions please reach out to our IR team. Thank you.

Operator
Thank you very much, sir. Ladies and gentlemen, that concludes this conference call and you may now disconnect your lines.

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