

TELKOM SOUTH AFRICA

INTRODUCTION

Edward E. Whitacre Jr., chairman and chief executive officer of SBC Communications in San Antonio, Texas, hung up the phone and leaned back in his chair. He was trying to decide how to interpret the news that was conveyed to him over the phone. Deutsche Telekom, the favored bidder for 30% of South Africa's state-run telecommunications provider (Telkom), announced it was pulling out of the bidding war. On one hand, this was great news to Whitacre because SBC Communications was also bidding for ownership of Telkom, in partnership with Telekom Malaysia Berhad. With Deutsche Telekom out of the way, SBC Communications was now the frontrunner in the bidding war for Telkom.

On the other hand, Whitacre worried how his Board of Directors would interpret this move and whether Deutsche Telekom's withdrawal would cause the Board to question SBC's bid for Telkom. Deutsche Telekom, Germany's newly privatized telecommunications firm, had performed extensive due diligence on Telkom. Had it learned something that scared the company off? Or had Deutsche Telekom merely overextended itself with recent purchases of Eastern European telecommunications providers? Deutsche Telekom's sudden change of heart could be a boon for SBC but it could also signal disaster.

Whitacre had committed the majority of his time for the past six months to preparing a bid for Telkom in consortium with Telekom Malaysia. He felt emotionally invested in the deal and was passionate about its fit with SBC's international expansion effort. Partial ownership of Telkom (18% SBC, 12% for Telekom Malaysia, and 70% retained by the South African government) would open a gateway to South Africa, and the entire continent of Africa¹, for SBC. South Africa was an ideal market because of its expanding economy, significant unmet demand for high-quality telecommunications services, and future as the African hub of global telecommunications traffic. Telkom was the clear investment choice in South Africa due to its state-enforced monopoly status until 2003² and desperate need for a partner with technical expertise.

Whitacre sent an email to his valuation team at SBC International (SBCI) to inform them of Deutsche Telekom's withdrawal and to request an update on their analysis of the price SBC should bid for Telkom. SBC's bid was due in less than two months, February 1997, and a lot of work remained to be done.

¹ South Africa has over 40% of approximately 10-million lines on the African continent. Luisa dos Santos, "Telkom Reduces Costs on International Calls." *International Market Insight* (December 3, 1997).

² The South African government promised bidders for Telkom that it would enforce a 5-year monopoly with an option for a sixth year if all conditions are met.

BACKGROUND ON TELKOM

History

In October 1991, the South African Posts and Telecommunications separated into three separate entities, one being Telkom South Africa (Telkom). Telkom was “commercialized” in a public offering with the state as its sole shareholder. As a commercial entity and public company, Telkom began to produce dividends, cut costs, stimulate productivity, increase efficiency, and operate under full public scrutiny. Along with the spin off, Telkom inherited a large and valuable infrastructure as well as an outstanding debt bill of 10.2 billion Rand.

Telkom had a painful transition from a government bureaucracy to business enterprise in 1991. Adoption of internationally acceptable commercial accounting practices and controls was a mess. Additionally, the transformation into a “client-focused” service company committed to practical and affordable solutions to telecom needs was traumatic.

National Framework Agreement

The Telkom privatization was part of the South African government’s program to partially privatize state enterprises (the National Framework Agreement, or NFA), commenced in 1995. Before the program began, state-owned enterprises accounted for one-quarter of the country’s total fixed capital assets.³ The NFA identified the following objectives for privatizing state-owned assets:

- Increasing economic growth and employment
- Meeting basic needs of all South Africans with a focus on the poor and disadvantaged
- Redeploying assets for growth
- Creating infrastructural development by mobilizing and redirecting private sector capital
- Reducing state debt
- Enhancing competitiveness and efficiency of state enterprises
- Financing growth and requirements for competitiveness
- Developing human resources

Telkom would be the largest partial privatization in Sub-Saharan Africa to date and the single largest foreign fixed investment in South Africa since the African National Congress (ANC) took power in 1994. The ANC chose to sell off only 30% of Telkom and keep the remaining 70% in the state’s ownership. Jay Naidoo, South Africa’s Minister of Posts and Telecommunications, said 30% was chosen “to bring in the commitment [of a foreign buyer] to become an active partner in the medium to long term.”⁴ Previously criticized for ambivalence towards Telkom, the ANC placed priority on privatizing Telkom because it was eager for reduced tariffs, extra calls, and higher tax revenues that resulted from recent telecom privatizations in other emerging markets.

³ “South Africa Privatization Progress.” *International Market Insight* (June 6, 1998).

⁴ Mark Ashurst, “Cornerstone of Development: Interview with Jay Naidoo.” *The Financial Times* (March 19, 1997): p. 2.

Perhaps more importantly, though, the ANC hoped foreign investment in Telkom would be of political benefit to the party by speeding up the delivery of basic services to the black majority. The apartheid system, overturned merely three years ago, left a legacy of low telephone access for blacks.⁵

Deal Requirements

As part of its Telkom privatization plan, the ANC government required new owners in Telkom to train blacks for management posts, roll out at least 2.7 million lines to under-served areas (particularly black-majority areas), and upgrade network capacity. In total, these requirements would cost the new owner approximately 53 billion Rand for infrastructure upgrades and 2.5 million Rand for training disadvantaged groups employed by Telkom (60% of the funds would be spent on literacy and sales and service skills). The objective was to create a management team with at least 35% of the members coming from disadvantaged backgrounds.⁶ These stringent requirements frightened off several potential bidders. See **Exhibits 1 and 2**.

TELECOMMUNICATIONS INDUSTRY IN EMERGING MARKETS

According to Sam Pitroda, founder of World-Tel and ex-Chairman of the Telecommunications Commission in India, “Modern telecommunications is an indispensable aid in meeting basic needs. . . Telecommunications lies at the very heart of progress.”⁷ Not only is telecommunications good for developing countries’ economic and social progress, it is also a lucrative and comparatively safe investment in emerging markets (due to the reliable stream of cash flows and high growth prospects). *Global Finance* journal states, with reference to emerging markets;

The surge of telecommunications privatizations in the 1990s, although financed primarily with conventional sources of debt and equity, introduced many institutional investors to the potential of the telecom business. At the same time, the revolution in technology and new telecommunications products and services enables investors in start-up corporations to realize profits at a much faster rate than traditional project finance borrowers.⁸

According to a 1995 McKinsey report titled, *Closing the Global Telecommunications Gap*, emerging markets with “high-readiness” for telecommunications investment (including openness to foreign direct investment, flexible financing requirements, tax benefits, technology neutrality, and lack of purchasing bias) offer returns on equity in the range of 20 to 30 percent.⁹ The report states;

⁵ South African racial composition: 75% black, 14% white, 9% colored, 2% Asian.

⁶ Case writers’ interview with Rob Hendricks.

⁷ Sam Pitroda, “Development, Democracy, and the Village Telephone.” *Harvard Business Review* (November/December 1993).

⁸ Peter Grant, “The Attraction of Telecom.” *Global Finance* (September 1998): p. 12-14.

⁹ McKinsey & Company (Australia), *Closing the Global Telecommunications Gap*. (1995): p. 31.

There is an ever-widening gap between the industrialized and developing world caused by, and reflected in, poor information infrastructure in lesser-developed countries. A vicious circle of underdevelopment exists whereby economic growth is needed to generate funds to improve telecommunications capacity and capability, but the poor availability and quality of telecommunications deters investors from providing the required capital. Consequently, despite 100 years of progress in telecommunications, nearly four billion of the world's five billion people continue to be denied the basic human right to communicate because they lack access to primary telecommunications services.¹⁰

Telecommunications in South Africa

South Africa, even though it “continues to set the pace for the continent [of Africa]”¹¹, significantly lags behind the developed world in telecommunications services. Measured by teledensity (the number of telephone lines per 100 people), South Africa had one of the least developed telecommunications infrastructures in the world in 1997 – which SBC considered a positive indication of unmet demand and strong growth potential. On average, South Africa had one telephone line per 100 blacks and 60 lines per 100 whites.¹² See **Exhibit 3**.

THE REPUBLIC OF SOUTH AFRICA

Political Transformation

From 1910 to 1961, South Africa was under the rule of the British Commonwealth. In 1961 an Afrikaner nationalist group called the National Party (NP) overthrew the British system and declared South Africa a republic. The NP transformed South Africa into a legal and political system of apartheid (translated as “separateness”) to enforce segregation, legally bind blacks to poor rural land, and ensure urban areas were “white” areas. Apartheid laws led to years of social, economic and political oppression for non-white South Africans.¹³

In 1960 the NP banned the African National Congress (ANC), the anti-apartheid party, from political participation. Accordingly, the NP imprisoned Nelson Mandela, president of the ANC, in 1962. The NP relied on brute force and a violent militia to control uprisings from the ANC and other anti-apartheid groups. During the 1980s, tensions climaxed and countries around the world took a stance against South Africa. In response, F.W. de Klerk, president of the NP, began to dismantle apartheid structures, lifted the ban on the ANC, and released Nelson Mandela from prison in 1990.¹⁴ Apartheid ended peacefully. In April 1994, South Africa had its first all-race election and Mandela was elected President.

¹⁰ McKinsey & Company, Australia, *Closing the Global Telecommunications Gap*. (1995): p. 6.

¹¹ Beth McGoldrick, “Calling the 21st Century: Competition, Consolidation, and Convergence. *Global Finance* (June 1998): p. 83-89.

¹² Roger Matthews and Mark Ashurst, “South Africa Sells Telcoms Monopoly.” *The Financial Times* (March 27, 1997): p. 8.

¹³ *Economist Intelligence Unit: Country Reports – South Africa (Political Background)*.

¹⁴ *Economist Intelligence Unit: Country Reports – South Africa (Political Background)*.

Open to Foreign Investment: A New Gateway to Africa

In July 1991, President Bush lifted the Comprehensive Anti-Apartheid Acts prohibition on U.S. investment in South Africa. Soon thereafter, the U.S. became South Africa's second-largest trading partner after Germany. The lifting of trade sanctions by the U.S. and other countries helped pull South Africa out of a five-year recession (1988-1992) caused by drought, political uncertainty, a sluggish international economy, and depressed world commodity prices.

Decidedly, South Africa emerged from its apartheid era as an engine of growth for Africa, a continent historically plagued by economic hardship. In particular, South Africa's new openness to trade promised to have a positive impact on southern Africa, a market of 120 million people.

The U.S. took a particularly strong interest in the potential of South Africa, both as a source of investment capital and a gateway to the continent of Africa. The U.S. government undertook numerous measures to encourage positive bilateral trade and investment relations with South Africa. As the most diverse economy in Sub-Saharan Africa with a relatively developed manufacturing sector,¹⁵ South Africa was a natural platform into the rest of Africa. Alec Erwin, minister of Trade and Industry in South Africa, stated;

I think we are as attractive as any country at the moment. This, with our political stability, the fact we are a democratic state, means we are a good destination . . . We are especially important for those investors who see the African market growing, which it is doing. And increasingly we are aspiring to form an important bridge between the rapid growth in South America and in Asia and the Middle East. South Africa is going to become a very important manufacturing destination for export trade with both regions. We are very strategically located for this sort of south-south cooperation.¹⁶

Compared to other emerging markets, South Africa possessed a modern infrastructure supporting an efficient distribution of goods to major urban centers throughout the region and well-developed financial, legal, communications, energy and transport sectors. Many economists described South Africa as a hybrid between the third and first worlds because of its mixed economic indicators.

Concerns about South Africa's potential still abound, though. The World Bank, which doesn't even include South Africa in its measurements of foreign direct investment, stated, "Despite South Africa's promise as a recipient of foreign direct investment, both its inflows and outflows remain small." In fact, South Africa attracts less than 1% of all foreign direct investment worldwide. In a global context, U.S. firms still predominantly invest in Latin America, Japanese firms in Southeast Asia, and European firms in Eastern Europe. Africa attracted only 2.4% of all foreign direct investment worldwide and remained a low priority for most investors.¹⁷

¹⁵ In 1995, manufacturing was 26% of South Africa's GDP – the highest percentage of any other African nation. Michael E.M. Sudarkasa, *The African Business Handbook*. (21st Century Africa, Inc.: 1996): p. 37.

¹⁶ Roger Matthews, "Investing in South Africa." *The Financial Times* (March 25, 1997): p. 6.

¹⁷ http://www.fm.co.za/Top_100/tc26.html

Telecommunications Hub

Within the telecommunications sector alone, South Africa accounted for more than 40% of telephones in the entire African continent.¹⁸ Many market analysts believed that Telkom's privatization would raise the bar for telecommunications all over Africa by introducing competition, foreign direct investment, and leading-edge technology. Naidoo declared South Africa's intention to become the African hub of global telecommunications traffic.

A 1996 U.S. Department of Commerce report described the telecommunications industry in South Africa as a "leading sector for U.S. exports and investment." After the democratization of South Africa, and subsequent lifting of sanctions, several U.S. telecommunications companies¹⁹ moved in, including AT&T, Lucent Technologies, Motorola, Sprint, Hughes Network Systems, Iridium, and Teledesic.

Because of its promising future as the African center of telecommunications traffic, Telkom was particularly attractive to outside investors. SBCI, in addition to valuing Telkom through a discounted cash flow model, considered valuing Telkom as a real option. For example, if an investment in Telkom generated a negative NPV, that cost could be seen as the price of an exercisable option to control telecommunications throughout Africa.

INVESTMENT RISKS AND CONCERNS

Country Risks

Violence

Political, economic and social tensions (particularly income inequality) continue to sustain a high level of violence in South Africa. Political conflict has claimed the lives of 14,000 South Africans since 1984. In most areas, though, the biggest concern is criminal violence. A 1995 study by the World Health Organization stated that South Africa had the highest murder rate in the world, along with high rates of rape and car/truck hijacks. Crime remains the biggest challenge to economic growth and the abatement of widespread poverty. Investors continue to site crime as the biggest deterrent to doing business in South Africa.

Openness to Foreign Investment

In general, the South African government applies the same regulations to domestic and foreign investments and, therefore, is perceived as foreign-investment friendly. For example, there are no caps on percentage ownership, no pre-screenings, and no performance requirements. However, there are local content requirements in the automotive, telecommunications, and television sectors. Also, foreign insurance and banking firms are required to incorporate locally.²⁰ Another restriction is that companies that are 25% or more owned or controlled by non-residents have

¹⁸ Luisa Dos Santos, "South Africa: Network Expansion." *Industry Sector Analysis* (September 1, 1997).

¹⁹ From sub-sectors of the telecommunications industry including fixed line, cellular, broadcasting, telecommunications equipment, and telecommunications services.

²⁰ Emily Solomon, Katie Moore, Dennis Goldenson, and Sally Miller, "South Africa: Forward Together." *The Big Emerging Markets* (1995): p. 301-313.

limits on local borrowings. This is to ensure adequate capitalization of foreign investments and to prevent borrowing against share capital.²¹

Despite its relative openness to foreign investment, three issues -- foreign exchange control, privatization, and competition -- were still problems for the South African economy. Although these three problems were priorities for the ANC, the government had been unsuccessful to date in making progress in loosening foreign exchange controls, accelerating the rate of privatization, or increasing competition. *The Financial Times* described, “Perversely, competition policy, on which the African National Congress shows most political will to make substantial change, is the one on which there has been least progress.”²²

Credit Rating

The sovereign rating for the Republic of South Africa by Moody’s in 1996 was Baa3 – the top non-investment grade rating.²³ In contrast, SBC Communications’ long-term credit rating was A-/A2 (S&P/Moody’s, respectively).

Poor Economy and Income Inequality

Since 1992, the volatility of the South African economy was reflected in its GDP, unemployment, inflation and interest rates [see **Exhibits 4 and 5**].

In 1994, the Reconstruction and Development Program was the centerpiece of the government’s plans to redress inequalities in the economy and revive growth prospects by increasing spending. Funding was to come from re-routing government expenditures, supplemented by foreign aid and joint-financing deals between the government and the private sector. However, actual spending was sluggish and overall impact on GDP was disappointing.

The whole story wasn’t disappointing, though. South Africa had made significant economic progress, mostly through the private sector. According to the *Financial Times*, “Judged against the emerging markets indices drawn up by global ratings agencies and investment banks, [South Africa’s] share of the world’s emerging markets funds lags well behind the theoretical targets. Yet, local institutions are loaded with cash, the stock market has sustained its bull run for more than three years, and the prospects for continued growth in corporate earnings are sound.”²⁴

The South African economy ranges from the affluence and sophistication of the first world – including gleaming shopping centers and an advanced financial services industry – to levels of poverty as extreme as the least developed countries in the world. South Africa has one of the most unequal distributions of income in the world with a Gini Coefficient of approximately .61 (second only to Brazil in income inequality). See **Exhibits 6 and 7**.

²¹ Emily Solomon, Katie Moore, Dennis Goldenson, and Sally Miller, “South Africa: Forward Together.” *The Big Emerging Markets* (1995): p. 301-313.

²² Roger Matthews, “Cautious Approach to Problematic Legacies.” *The Financial Times* (March 25, 1997).

²³ “Telkom SA \$185M Bank Credit Pact Rated Baa3 By Moody’s.” *Dow Jones News Service* (September 9, 1996).

²⁴ Mark Ashurst, “Investing in South Africa.” *The Financial Times* (March 25, 1997): p. 04.

Political Uncertainty

Jim Myers, President of Southwestern Bell International Development, Africa, stated, “The new government of South Africa has no history on which it can be judged.”²⁵ The ability of the government to govern and manage the economy had so far gone unproved and, therefore, was constantly being challenged. People were concerned that the ANC would concentrate more on short-term political objectives than the long-term goal of managing the economy. Would the ANC revert to “handouts” or would it stick to its original plan of fiscal discipline.

In addition, the right-wing AWB and Conservative parties were threatening to become militant in order to reinstitute a system of apartheid. These right-wing parties placed many obstacles in the way of political reform.

Company Risks

Technical Disrepair

By February 1997, Telkom’s infrastructure was in technical disrepair. Faulty lines went unrepaired, public telephones were virtually non-existent²⁶, a large percentage of customers had service suspended for late payment every month, cable theft was rampant, and the number of Telkom customers was actually shrinking – extremely unusual in an emerging market. Telkom’s trademarks included “high prices, slow service, an aloof bureaucracy, a bloated work force, and a network engineered for white neighborhoods.”²⁷

Abhorrent customer service was one of Telkom’s biggest problems. When a residential customer ordered service, it took Telkom approximately 14 days just to process the order – not including phone installation. The average installation time in early 1997 was, on average, 40 days. Only 57% of residential and corporate customers were able to use their phones within 28 days of ordering service. When home phone service broke down, as so often happened, Telkom took an average of 103 hours (82 hours for corporate customers) to fix the fault.²⁸

Even though SBC was a leading telecommunications provider, Whitacre wondered whether any organization – no matter how advanced – could tackle Telkom’s problems.

Debt Burden

Beginning in 1991, Telkom increased its leverage by borrowing to meet current capital expenditures. The majority of the debt was secured through Telkom stock as well as the government’s guarantee. In 1995 and 1996, Telkom had extreme debt levels on its balance sheets [see **Exhibit 8**] in the form of interest bearing debt, denominated in Rand, U.S. dollars, Deutschmarks, and Pounds. In 1995 and 1996, Telkom company had total interest bearing debt of R9.67 billion and R9.99 billion, respectively, with interest rates ranging from 10% to 18.5% (average effective rate was 16.7%). Annual interest payments equaled R1.6 billion. Payments on

²⁵ Gregory J. Millman, “Some good news.” *Infrastructure Finance* (May 1997): p. 54-56.

²⁶ People stole public telephones for their scrap metal value. “Business: VeldCom.” *The Economist* (May 16, 1998).

²⁷ Donald G. McNeil, “Can Phone Service Improve in Absence of Competition?” *The New York Times* (December 17, 1997): p. D1.

²⁸ Case writers’ interview with Mac Geschwind, Chief Operating Officer of Telkom SA.

mature debt are scheduled between 1996 and 2008. The value of debt to equity was 1.6 in 1995, and 1.4 in 1996.²⁹

Obviously, Telkom relied heavily on debt financing. This made it difficult to borrow from the capital market at commercial rates. For example, Moody's Investor Service assigned a Baa3 rating to an \$185 million unsecured bullet loan bank credit agreement issued to Telkom. Baa3 is the Republic of South Africa's sovereign credit rating,³⁰ which constrains the rate at which Telkom can borrow. Telkom's aggressive expansion plans required a great deal more capital. With its history of high leverage, though, Telkom faced the threat of a credit rating downgrade if it took on even more debt.

Cellular Service: A Substitute Product

The single market solution to Telkom's poor service was wireless communications, launched in 1994. Telkom's monopoly didn't extend into the cellular sector, although it held a 50% stake in Vodacom – one of the two cellular license holders in South Africa. The other cellular service provider was Mobile Telephone Networks (MTN). Vodacom was the market leader between the two competitors. Both held a 15-year license to operate competing cellular phone networks in South Africa, although the South African government was considering issuing new cellular licenses within two years (before January 1999).³¹

Despite its stake in Vodacom (and the fact that Telkom held a monopoly for connecting cellular base stations to its backbone network³²), the cellular revolution was incredibly troublesome for Telkom for a number of reasons. First of all, with its monopoly-based pricing structure, cellular service was only marginally more expensive than wire-line service from Telkom and often more reliable. Secondly, cellular service was a very efficient revenue generator due to the fact that more rural customers could be serviced more cost effectively in a wider area without the burden of having to lay cables. In addition, wireless technology required less maintenance and eliminated the threat of copper cable theft.

Racial Tension

In 1993, Telkom was a predominately white male company. After apartheid was repealed, Telkom launched plans to incorporate more blacks into managerial roles. The top executives conducted a search to count the number of black managers within Telkom's 58,000 employees as of 1994. They found 1. Therefore, Telkom began an aggressive plan to promote, train and hire more blacks. This resulted in a strike of 5,300 white Telkom employees protesting the new policy to increase black representation within the company. They cited reverse discrimination as Telkom's offensive behavior. In 1995, Telkom had 83 black managers (8% of the managerial layer). Telkom pledged to increase the percentage of blacks in managerial positions to more than 35% by 2002.

²⁹ Telkom Annual Report, <http://www.telkom.co.za>.

³⁰ "Telkom SA \$185M Bank Credit Pact Rated Baa3 By Moody's." *Dow Jones News Service* (September 9, 1996).

³¹ Derrick Cogburn, "Ready to Spring Into Action; South Africa's Telecommunications Industry." *Communications International* (December 1996): p. 57.

³² "South Africa: Africa's role model?" *Telecommunications* (October 1995): p. 106.

As Telkom proceeded with this campaign, though, white managers and employees were becoming more and more nervous. The company culture was fraught with racial tension. Telkom expected some form of a backlash as blacks were promoted to managerial positions above the whites who once managed them. Telkom couldn't predict what form this backlash would take, though.

Copper Cable Theft

One of the biggest risks of the telecommunications industry in South Africa was the rampancy of cable theft – relatively common in emerging markets. People would dig up cables to sell them for their copper content. Incidents of cable theft in South Africa were at an all-time high in 1996: 4,112 cables stolen at a cost of 41.1 million Rand. Ben Bets, Telkom's managing director of customer service, expressed his frustration, "As soon as we fix one portion of the network, another is stolen." Bets added that customers, staff morale, and revenues are all adversely affected by cable thefts, which can halt service for several months.³³

Several efforts were being made to reduce cable theft including community policing, legislation to clamp down on sellers of stolen copper, and replacing copper wire with fiber optic cables. However, these efforts were yet to payoff – especially the fiber optic cable replacement because thieves would have to dig up the cables to discover they weren't composed of copper.

Rob Hendricks, a Senior Financial Analyst at SBCI and direct report to SBC's CFO, said cable theft was a major concern to SBC in evaluating the potential purchase of Telkom. He mentioned Wireless Local Loop (WLL) technology, a combination of wire-line and wireless connections, as a solution. "The Wireless Local Loop technology being deployed in rural areas addresses the network coverage in the rural areas and robbery of copper wire. The underlying technology of WLL is similar to household cordless phones found in the U.S. Political uncertainty and high crime continues to hamper the economic development of South Africa."³⁴

THINTANA

Telekom Malaysia Berhad and SBC Communications Consortium

Although not an obvious match, Telekom Malaysia and SBC joined together in a consortium called Thintana to purchase a 30% interest in Telkom South Africa (18% SBC, 12% Telekom Malaysia). The partnership was announced in mid-December 1996. Previous to this date, Telekom Malaysia and SBC were considered rival bidders.³⁵ Rob Hendricks stated, "The government of Malaysia and South Africa have a long history of cooperation. As a strategic partner, Telekom Malaysia offered SBC a proven ability in upgrading telecommunications networks in developing countries. Thintana was formed as a separate legal entity to bid on 30% of Telkom South Africa."³⁶

³³ Marina Bidoli, "South Africa: Preparing for Liberalisation." *Telecommunications* (April 1998): p. S12-S16.

³⁴ Case writers' interview with Rob Hendricks.

³⁵ Mark Ashurst, "SA Telecoms Bidders Combine." *The Financial Times* (December 19, 1996): p. 16.

³⁶ Case writers' interview with Rob Hendricks.

Jim Myers commented, “SBC’s role in helping in the rapid modernization of Telmex, the Mexican phone company, coupled with Telekom Malaysia’s robust growth in telephone service and technical leadership in rural telephony provide a unique combination of strengths that make us an ideal partner for South Africa.”³⁷ The CEO of Telekom Malaysia, Dato’ Mohamed Said Mohamed Ali, confirmed the fit by saying, “Telekom Malaysia is confident that, in partnership with SBC International, it has the knowledge, experience, and technology to make a significant contribution to meeting the needs of the people of South Africa as Telkom South Africa’s strategic equity partner.”³⁸

Malaysia had strong commercial links with South Africa and the U.S. was increasing its foreign investment in the country. Prior to this offering, both companies had smaller investments in Africa. Telekom Malaysia has interests in Gambia, Ghana and Malawi and SBC had purchased a 15.5% interest in MTN, a cellular network in South Africa.

Telekom Malaysia Berhad

Thintana felt it stood a reasonable chance of securing a 30% stake in Telkom despite competition, in part because of Malaysia’s expertise in the provision of rural telecommunications services.³⁹ Telekom Malaysia has presence in a number of developing countries including India, Malawi, Sri Lanka, Indonesia, the Philippines and Iran. By early 1997, Telekom Malaysia was in negotiations for joint ventures in Bosnia-Herzegovina, Oman, Vietnam, Cambodia and a sub-Saharan nation.⁴⁰ Telekom Malaysia privatized in 1990 and was the largest publicly listed company in Malaysia. 1996 revenues were US\$2.6 billion [see **Exhibit 9**].

Not only did Telekom Malaysia have experience in developing markets, it had direct and recent experience in Africa. In December 1996, Telekom Malaysia purchased a 30% stake in Ghana Telecom for US\$38 million. Telekom Malaysia beat out rival bidders Deutsche Telekom, KPN of the Netherlands, Western Wireless and Lightcom, and Telkom South Africa in a single-round, sealed-bid auction (companies were required to meet a certain technical threshold before submitting a bid).⁴¹

SBC Communications Inc.

In 1997 SBC Communications Inc. was one of the world’s leading diversified telecommunications companies. Founded as a baby bell in Texas, SBC provided innovative telecommunications products and services under the Southwestern Bell, Pacific Bell, Nevada Bell, SNET, and Cellular One brands. Its businesses included wire-line and wireless services and equipment, cable television and directory advertising and publishing. After the Telecommunications Act of 1996 passed (which largely deregulated the industry), SBC quickly became an active player in acquiring and merging with other baby bells. For example, in April

³⁷ <http://www.sbc.com>

³⁸ <http://www.sbc.com/News>

³⁹ Jennifer Jacobs, “Reasonable chance of getting Telkom Stake.” *The New Press Times* (March 8, 1996): p. 5.

⁴⁰ Jailani Harun, “Race for 30% of Telkom S. Africa.” *The New Press Times* (February 21, 1996): p. 1.

⁴¹ Joel Kibazo, “Enticement Comes Out of Africa.” *The Financial Times* (December 23, 1996): p. 24.

1996, SBC merged with San Francisco based Pacific Telesis Group.⁴² In addition to expanding domestically, SBC began a campaign to target strategic telecom partners to expand operations globally.

SBC was internationally diverse with operations on five continents via strategic acquisitions and joint ventures. SBC continued to aggressively pursue opportunities in high-growth international markets. By early 1997, SBC had interests in China, France, Israel, Mexico, South Korea, Switzerland, Taiwan and Japan.⁴³ Success with telecom partners in these markets provided SBC with “experiences that reflected how a strong partnership can help transform a telecommunications monopoly into a responsive, customer-focused company.”⁴⁴

In 1995 and 1996, SBC ranked number 1 among Fortune Magazine’s Most Admired Telecommunications companies.⁴⁵ Additionally, SBC was a Fortune 25 company and had tens of millions of customers in 13 U.S. states and 8 countries. See **Exhibit 10** for SBC’s financial statements.

MTN

As part of SBC’s global expansion, SBC invested \$90 million to acquire a 15.5% interest in MTN, one of South Africa’s two national cellular service providers. The deal was transacted in September 1995. MTN used the proceeds to fund the expansion of its nationwide cellular network and to increase its marketing capacity. At the same time, SBC (along with Cable and Wireless PLC, in the United Kingdom), entered into a joint venture with New Africa Investments Ltd., South Africa’s largest black-controlled publicly listed company and the parent company of Naftel, a partner of MTN. The joint venture was established to explore telecommunications opportunities in South Africa and nine other African countries.⁴⁶

Suddenly, with the emergence of the Telkom opportunity, SBC’s partial ownership of MTN became problematic. Since Telkom owned 50% of Vodacom, MTN’s only cellular phone rival in South Africa, SBC could be construed as a rival to Telkom. The South African Department of Posts and Telecommunications considered the cross-holdings to raise considerable competition policy issues. SBC could be certain that the South African government would place a condition on SBC’s bid for Telkom – if SBC won the bid it would have to sell its 15.5% stake in MTN.

VALUATION

Rob Hendricks received Whitacre’s e-mail message requesting an update on the Telkom valuation model. He reviewed the model and, once again, experienced frustration at the overwhelming amount of uncertainty that surrounded the deal. He wished he had more time to

⁴² <http://www.sbc.com>

⁴³ <http://www.sbc.com>

⁴⁴ “Telkom Deal.” *The New Press Times* (May 15, 1997): p. 1.

⁴⁵ <http://www.sbc.com>

⁴⁶ “SBC Communications to Acquire 15.5% Stake In MTN.” *Dow Jones News Service* (August 7, 1995).

fully explore each assumption, but the bid was due in a matter of weeks. Hendricks decided to go through each uncertainty and assumption before presenting the model to Whitacre.

Exchange Rates

Since the early 1980's, the floating Rand fluctuated widely due to plunging bond markets and the lack of confidence in the government. From 1995 to 1996, the Rand devalued from 4.2 Rand/USD to 4.4 Rand/USD and had devalued against the dollar consistently since 1990. Even as South Africa opened its economy to the world in 1994, it struggled to gain respect in foreign markets since it hadn't yet formed a solid economic policy or controlled residual foreign-exchanges policies. In May 1996, South Africa had 14 billion Rand (\$3.2 billion) in foreign-exchange reserves, only equal to four to six weeks of imports.⁴⁷

The average historical depreciation rate of the Rand from 1990 to 1997 was 10%, which Hendricks decided to use in his model. However, as the South African economy strengthened (as many economists predicted it would) the Rand would begin to appreciate. Hendricks wondered how to account for this major uncertainty. See **Exhibit 11** for more information on historical exchange rates.

Taxes

Telkom was commercialized as a public entity in 1991 with the state as the only shareholder. All profits from the company were funneled back to the State via taxation and/or dividends. In 1995, however, Telkom paid an effective tax rate of 23%, which included one-time deductions and exemptions. The marginal tax rate on corporations in 1997 was 35%, but the presiding rumor was that the South African government would soon reduce corporate tax rates by three to five percent in order to induce investment.

Depreciation on Assets

Telkom's average rate of depreciation on assets was 12% for the past 5 years, using the straight-line method. However, Telkom had the option to use an accelerated depreciation method, which would write-down assets in 4 years.

Post-Monopoly Scenario

The South African government guaranteed new investors in Telkom a five-year monopoly with an option for a sixth year if all requirements are met. The sixth year of monopoly would expire in 2003. During the enforced monopoly period, SBC expected the growth rate of revenues-per-line and costs-per-line to match historical rates. Was this a correct assumption, though, considering Telkom's aggressive expansion plans? And how should Hendricks account for sales growth after 2003? SBC had no idea what would happen after 2003 – except that revenue-per-line would probably decline due to the introduction of competition. Hendricks explained;

⁴⁷ Michael Sesit, "South Africa Seeks Means to Win Back Investors" *The Wall Street Journal Europe* (May 2, 1996): p. 13.

SBC is projecting a loss in market share after the period of exclusivity expires and competition enters the market. The government of South Africa will determine if Telkom is allowed another year of exclusivity if they meet the service and access line targets established during the privatization. The regulation of the industry is evolving, however. The vision of the government of South Africa is the provision of basic universal service to disadvantaged rural and urban communities with the delivery of high-level services capable of meeting the needs of a growing South African economy. To that end, the government established an independent regulator, the South African Telecommunications Regulatory Authority (SATRA), to regulate telecommunications in the public interest. At this time, SATRA has not determined the nature and time frame for introducing competition in the South African market. They are exploring the feasibility of licensing more than two public operators after 2003.⁴⁸

The possibility existed that the government would actually aid competition against Telkom after 2003 by offering inducements to new entrants. This was not uncommon in other countries that had privatized their telecom sectors. Hendricks had no idea how to account for revenue-per-line or capital expenditures in the post-monopoly period – or whether Telkom would even earn the sixth year of monopoly status.

Listing of Shares

The South African government planned to list Telkom's shares on the Johannesburg stock exchange after the monopoly expired in 2003. Therefore, Hendricks considered the benefit of a model based on P/E multiples. He had already collected a list of comparable companies to estimate Telkom's beta [see **Exhibit 12**] which he could use to project an exit-year P/E multiple.

Telecom projects are less risky compared with other foreign direct investment projects (as measured by their betas when regressed on the domestic market). However, emerging market telecom companies have higher betas (all above 1) when regressed on the U.S. market.

Hendricks' comparables were all listed on the New York Stock Exchange and Telkom would be listed on the Johannesburg Stock Exchange – a dramatically different scenario. According to the Economist Intelligence Unit, "The performance of the Johannesburg Stock Exchange (JSE) since January 1996 has been fairly weak as the result of a combination of factors, including several runs on the value of the Rand, dwindling net capital inflows, exchange controls, high interest rates, and, most recently, the contagion effects of the crisis in Asia."⁴⁹ The JSE Overall Index fell from 8,700 to 7,570 between January 1996 and mid-December 1996. The table below compares the JSE with other stock exchanges in Sub-Saharan Africa.

⁴⁸ Case writers' interview with Rob Hendricks.

⁴⁹ *Economist Intelligence Unit: Country Reports – South Africa (Political Background)*.

Table 1: Sub-Saharan African Stockmarkets, 1997⁵⁰

	Year of Opening	Market Capitalization (billion US\$)	Number of Listed Companies
South Africa	1887	232.1	642
Nigeria	1960	3.6	182
Zimbabwe	1946	2.0	64
Kenya	1954	1.8	58
Mauritius	1989	1.7	40
Cote d'Ivoire	1974	1.3	35
Ghana	1990	1.1	21
Zambia	1994	0.7	6
Namibia	1992	0.7	13
Total		246	

Management

If Thintana is chosen for 30% ownership of Telkom, SBC and Telkom Malaysia would be entitled to influence decision making at Telkom through four seats on Telkom's Board of Directors (out of 13 total), split evenly between the two bidders. In addition to board representation, SBC and Telekom Malaysia would be allowed to send a large number of executive managers to Telkom, particularly to the divisions dealing with technology and infrastructure.

SBC was adamant that it wouldn't consider placing a bid if it didn't have significant decision-making power at Telkom. Were four seats sufficient to make Thintana's voice heard, though? The South African government was adamant about not giving up more than four seats. This was a concern to Thintana since many of the remaining directors were members of the "old guard" which had run Telkom under a system of inefficiency and apartheid.

Financing

SBC International (SBCI) expected to borrow the funds necessary to purchase 18% of Telkom through its parent company, SBC. SBC Communications credit rating on long term borrowings was A-/A2 (S&P/Moody's) in 1997.⁵¹ SBCI wouldn't raise any Rand-denominated debt for the investment and did not plan to hedge against currency risk.

Cost of Capital

One of the biggest areas of uncertainty in the valuation model was the cost-of-capital. Hendricks had several choices for how to calculate the cost-of-capital and each method arrived at a significantly different answer. Only a few components of the cost-of-capital were known with any certainty:

⁵⁰ *Economist Intelligence Unit: Country Reports – South Africa (Political Background)*.

⁵¹ Case writers' interview with Rob Hendricks.

- Telkom's expected (post-privatization) debt-to-value ratio was 29%.
- Beta of telecommunications companies in emerging markets was, on average, 1.2 when regressed against the world market.

If Hendricks decided to use the Capital Asset Pricing Model (CAPM), should he adjust the beta downwards (from approximately 1.2) to account for the lower risk of telecommunications? Should he use the CAPM at all? He had been presented with several other methods that might be more appropriate for an emerging market. This decision weighed heavily on Hendricks since the model proved to be very sensitive to the discount rate.

CONCLUSION

Depending on what assumptions Hendricks plugged into the model, he got dramatically different valuations for Telkom. If SBC ended up winning the bid by overpaying, the fury would come down on Hendricks. If SBC offered too low of a price, lost the bid, and missed out on a once-in-a-lifetime opportunity to control telecommunications traffic in South Africa and on the entire African continent, the backlash against him would be just as strong.

If only there were some way he could find out why Deutsche Telekom pulled out of the bid, Hendricks would be able to adjust his assumptions based on Deutsche Telekom's information. On the other hand, now that Deutsche Telekom was out of the picture, SBC had more negotiating power with the South African government.

Hendricks took a deep breath and sent an e-mail message to Whitacre saying, "I'm ready to present the model. When are you available?"

Exhibit 1: Network Expansion and Modernization: Capital Expenditure

Year	Amount (in Rands)
1996/1997	4.1 billion
1997/1998	6.9 billion
1998/1999	9.75 billion
1999/2000	10.99 billion
2000/2001	10.95 billion
2001/2002	11.05 billion

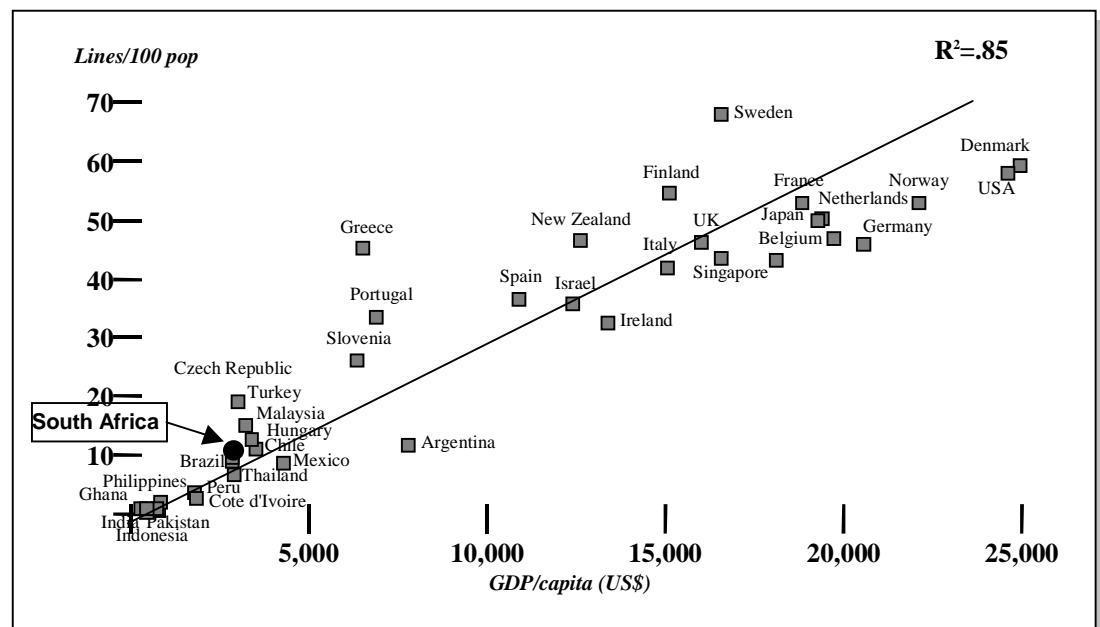
Source: *Telecommunications* (April 1998)

Exhibit 2: Telkom Expansion Targets

Year	New Access Lines	Under serviced Areas	Payphones
1997/98	325,000	265,000	20,000
1998/99	460,000	318,000	25,000
1999/2000	600,000	359,000	25,000
2000/2001	700,000	357,000	25,000
2001/2002	690,000	378,000	25,000

Source: *Telecommunications* (April 1998)

Exhibit 3: Teledensity (# of phone lines per 100 people) of Selected Countries vs. GDP/Capita



Source: McKinsey & Company (Australia), *Closing the Global Communications Gap*.

Exhibit 4: South Africa – Macroeconomic Data (1997 data are estimates)

	1996	1997
GDP (US \$ billion)	126.2	129
Gross Domestic Inv / GDP	17.4	15.9
Exports / GDP	27.5	27.8
Gross National Savings / GDP	16.0	14.4
Current a/c Bal. / GDP	-1.6	-1.5
Interest Payments / GDP	0.7	0.6
Total Debt / GDP	20.6	19.5
Structure of the Economy (% of GDP)		
Agriculture	4.8	4.5
Industry	38.7	38.5
Manufacturing	23.7	23.9
Services	56.4	56.9
Imports	26.2	26.6
Private Consumption	61	61.6
General Govt. consumption	20.4	21.3
Prices and Govt. Finance		
Consumer Prices	7.4	8.6
Implicit GDP Deflator	8.5	7.8
Current Revenue of Govt. (% of GDP)	31.7	32.3
External Debt (US \$ million)		
Total Debt Outstanding	26,050	25,222
Total Debt Service	3,782	4,263

Source: World Bank (9/8/98).

Exhibit 5a: Real GDP Growth Percentage

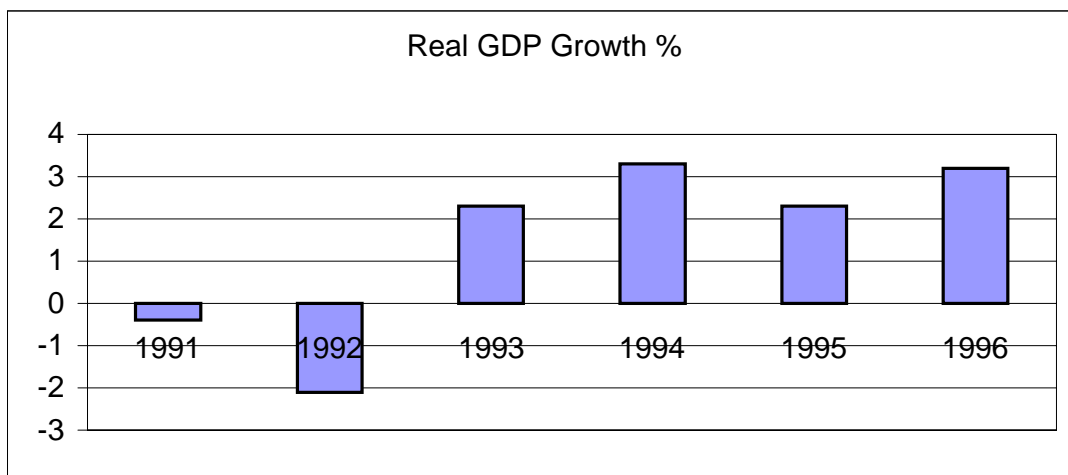


Exhibit 5b: GDP (\$ billion)

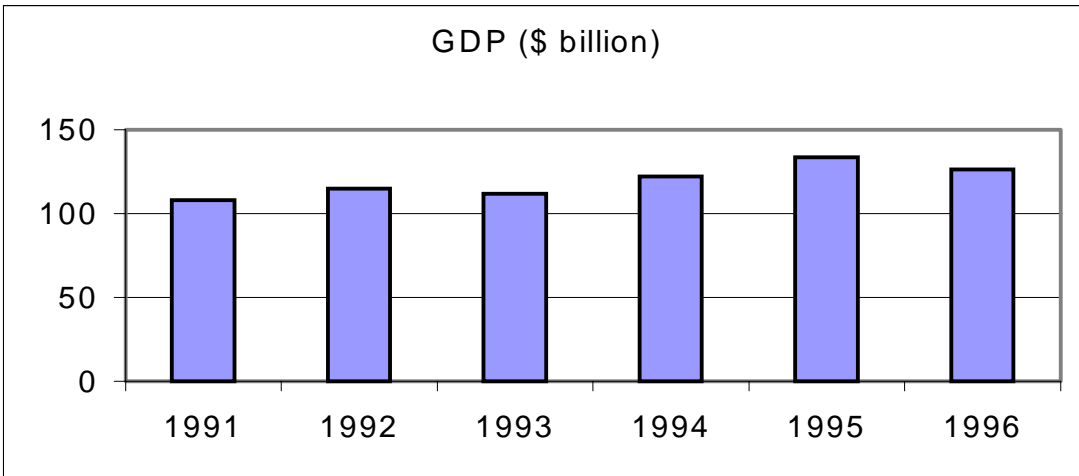


Exhibit 5c: GDP / Capita (\$)

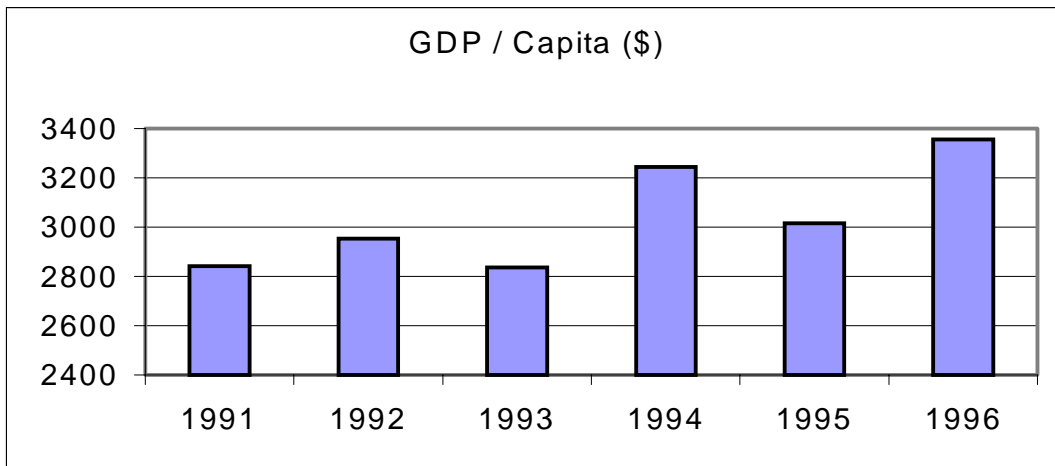


Exhibit 5d: Interest Rates (Reserve Bank Discount Rate – Bank Rate)

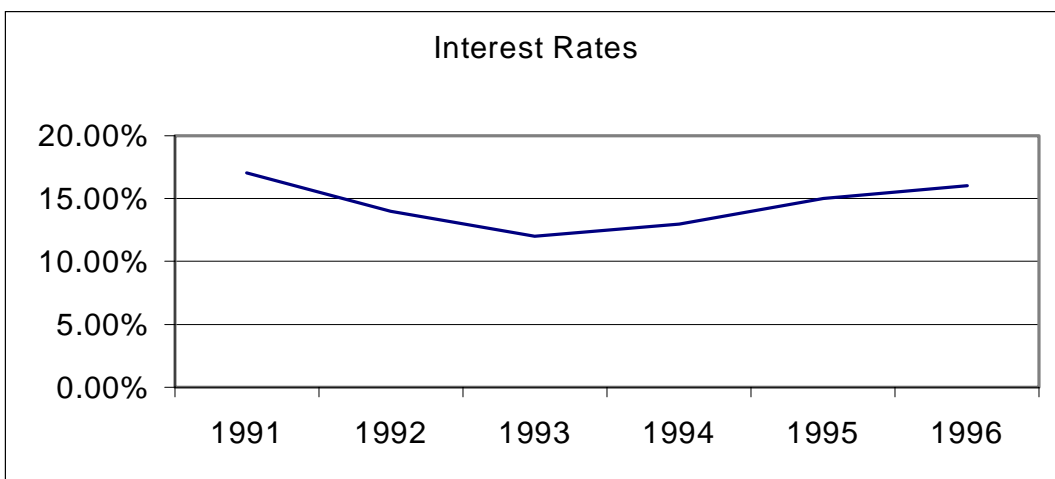


Exhibit 5e: Inflation

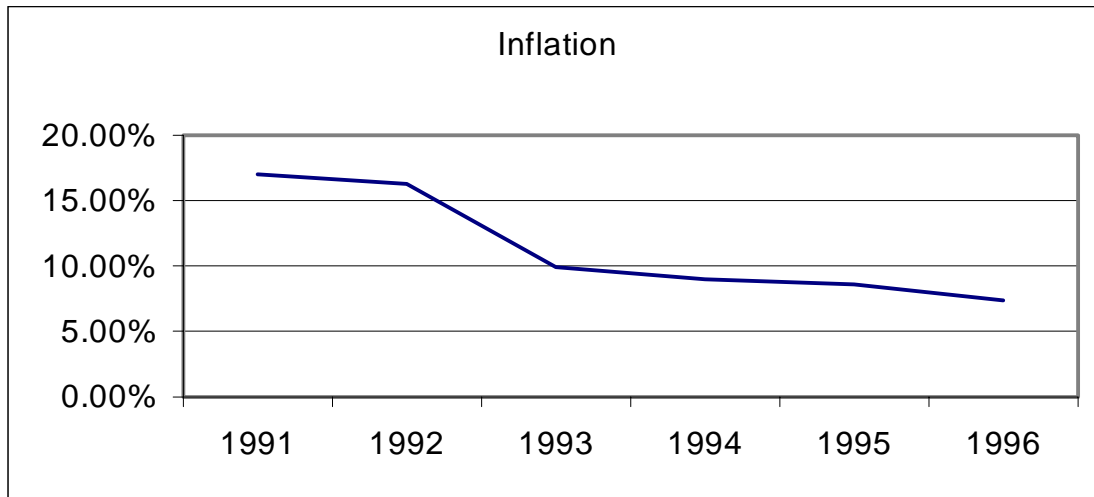


Exhibit 6 : Income inequality and comparative social indicators

1992	Thailand	Poland	Chile	South Africa	Brazil	Malaysia	Venezuela
Gini coefficient (1)	0.43	0.27	0.58	0.61	0.63	0.51	0.44
GNP per capita US\$	1,840	1,910	2,730	2,670	2,770	2,790	2,910
Life expectancy, years	69	70	72	63	66	71	70
Adult literacy rate %	10	n.a.	7	39	19	22	8
Total fertility rate (2)	2.2	1.9	2.7	4.1	2.8	3.5	3.6
Infant mortality rate (3)	26	14	17	70-100	57	14	33
Access to safe water %	77	89	87	70	86	70	92

Source: "Key Indicators of Poverty in South Africa", prepared by the World Bank for the RDP office.

Notes :

- (1) Gini Coefficient is an indicator of income distribution. The higher the value the more unequal the distribution.
- (2) Live births per adult female.
- (3) Infant Mortality rate indicates the percentage of deaths prior to 1 year.

Exhibit 7 : Average household total monthly wage by race (Rand). Shaded areas indicate quintiles of population groups which can afford household telecommunication services.

	All South Africans	Quintile1 Poorest	Quintile 2	Quintile 3	Quintile4	Quintile5
African	757	281	519	859	1,254	2,652
Coloured	1,744	485	862	1,500	2,292	3,165
Indian	3,371	n.a.	1,081	1,148	2,496	5,661
White	4,695	n.a.	1,073	1,091	2,620	5,055
Average of All	1,598	287	546	930	1,611	4,689

Source: "Key Indicators of Poverty in South Africa", prepared by the World Bank for the RDP office.

Exhibit 8a: Telkom Balance Sheet (in 1,000s of Rands)

(in R000's)	1996	1995
Assets		
Tangible assets	15,346,310	14,784,723
Participating interests	117,467	108,922
Fixed asset investments	51,095	45,806
Investments	529,178	216,530
Inventories	670,568	611,880
Accounts receivable	2,293,788	2,055,085
Cash on hand	7,685	5,291
Total Assets	19,016,091	17,828,237
Liabilities		
Accounts payable	2,576,112	2,471,405
Taxation	169,641	140,397
Shareholder for dividend	302,062	225,258
Net interest-bearing debt	8,522,292	8,380,270
Short term provision	156,735	133,597
Provisions	919,596	796,437
Deferred Taxation	3,097	220,501
Total Liabilities	12,649,535	12,367,865
Shareholder's Interest		
Share capital	3,899,223	3,899,223
Distributable reserves	2,467,333	1,561,149
Shareholder's interest	6,366,556	5,460,372
Total Shareholder's Interest and Liabilities	19,016,091	17,828,237

Exhibit 8b: Telkom Income Statement (in 1,000s of Rands)

(in R000's)	1996	1995
Revenue	12,578,209	10,567,288
Net operating expenses	(9,574,874)	(7,940,849)
Operating profit	3,003,335	2,626,439
Income from investments	21,521	32,175
Net financing charges	(1,402,114)	(1,330,922)
Profit before taxation	1,622,742	1,327,692
Taxation	(414,496)	(482,973)
Net profit attributable to ordinary shareholder	1,208,246	844,719
Ordinary dividend paid	(302,062)	(225,258)
Retained profit for the year	906,184	619,461
Earnings per share	0.310	0.217
Dividend per share	0.077	0.058

Exhibit 8c: Telkom's Cash Flow Statement

(in R000's)	1996	1995
Operating:		
Cash received from customers	12,625,409	10,525,520
Cash paid to suppliers and employees	(7,832,938)	(5,805,872)
Taxation paid	(602,656)	(236,888)
Dividend paid	(225,258)	0
Cash flow from operating activities	3,964,557	4,482,760
Investing:		
Income from investments	21,521	32,175
Net financing charges paid	(1,216,229)	(1,140,505)
Proceeds on disposal of tangible fixed assets	74,253	104,821
Replacement and renewal of tangible fixed assets	(1,920,852)	(2,147,557)
Additions to tangible fixed assets	(517,812)	(476,048)
Deposits on asset purchases realised	59,978	141,034
Additions to fixed asset investments	(8,966)	(45,806)
Increase in other investments	(18,619)	(7,037)
Increase in participating interests	(8,545)	(24,699)
Investment in joint ventures	(247,455)	(194,256)
Investment in subsidiary	(32,925)	0
Liquidation dividend from subsidiary	11,720	0
Cash flow in investing activities	(3,803,931)	(3,757,878)
Financing:		
Net increase in interest-bearing debt	78,869	168,638
Deposits realised	(59,978)	(141,034)
Increase in interest-bearing investments	(351,099)	(209,981)
Cash flow from financing activities	(332,208)	(182,377)
Net (decrease)/increase in cash and cash equivalents	(171,582)	542,505
Cash and cash equivalents at beginning of year	996,483	453,978
Cash and cash equivalents at year-end	824,901	996,483

Exhibit 9: Telekom Malaysia Profit and Loss Accounts (in millions of US\$)

	1996
Operating Revenue	\$ 2,468.88
Operating Costs	\$ (1,557.88)
Operating Profit	\$ 911.00
Non-Operating Income	\$ 27.28
Net Finance Cost	\$ 0.44
Net Operating Profit	\$ 938.72
Share of Profit less Losses of Associated Companies	\$ -
Profit Before Tax	\$ 938.72
Tax	\$ (190.80)
Profit After Tax	\$ 747.92
Minority Interests	\$ -
Profit for the Year	
Attributable to Shareholders	\$ 747.92
Dividend	\$ (98.04)
Retained Earnings	\$ 649.88

Exhibit 10a: SBC Communications, Inc. Consolidated Balance Sheet

	December 31,	
Dollars in millions except per share amounts	1996	1995
Assets		
Currents Assets		
Cash and cash equivalents	\$242	\$490
Short-term cash investments and other current assets	513	310
Accounts receivable-net of allowances for uncollectibles of \$138 and \$134	2,575	2,389
Material and supplies	116	131
Prepaid expenses	261	157
Deferred charges	205	202
Total current assets	3,912	3,679
Property, Plant and Equipment - Net	14,007	12,988
Intangible Assets - Net of Accumulated Amortization of \$607 and \$548	2,485	2,679
Investments in Equity Affiliates	1,955	1,586
Other Assets	1,090	1,070
Total Assets	\$23,449	\$22,002
Liabilities and Shareowners' Equity		
Current Liabilities		
Debt maturing within one year	\$1,722	\$1,680
Accounts payable and accrued liabilities	3,839	3,125
Dividends payable	259	251
Total current liabilities	5,820	5,056
Long-Term Debt	5,505	5,672
Deferred Credits and Other Noncurrent Liabilities		
Deferred income taxes	784	723
Postemployment benefit obligation	2,720	2,736
Unamortized investment tax credits	255	287
Other Noncurrent liabilities	1,530	1,272
Total deferred credits and other noncurrent liabilities	5,289	5,018
Shareowners' Equity		
Preferred shares (\$1 par value, 10,000,000 authorized:none issued)		
Common shares (\$1 par value, 2,200,000,000 authorized: issued 620,483,301 at December 31, 1996 and 1995)	620	620
Capital in excess of par value	6,322	6,298
Retained earnings	1,739	672
Guaranteed obligations of employee stock ownership plans	(229)	(272)
Foreign currency translation adjustment	(633)	(581)
Treasury shares (20,616,939) at December 31, 1996 and 11,122,981 at December 31, 1995, at cost)	(984)	(481)
Total shareowners' equity	6,835	6,256
Total Liabilities and Shareowners' Equity	\$23,449	\$22,002

Exhibit 10b: SBC Communications, Inc. Statements of Income

Dollars in millions except per share amounts	1996	1995	1994
Operating Revenues			
Local service	\$7,394	\$6,549	\$5,788
Network access	3,244	3,067	2,857
Long-distance service	945	841	917
Directory advertising	914	953	947
Other	1,401	1,260	1,263
Total operating revenues	13,898	12,670	11,772
Operating Expenses			
Cost of services and products	4,135	3,806	3,747
Selling, general and administrative	3,967	3,657	3,225
Depreciation and amortization	2,240	2,170	2,038
Total operating expenses	10,342	9,633	9,010
Operating Income	3,556	3,037	2,762
Other income (Expense)			
Interest expenses	(472)	(515)	(480)
Equity in net income of affiliates	244	156	223
Other income (Expense) - net	(61)	114	(71)
Total other income (expense)	(289)	(245)	(328)
Income Before Income Taxes and Extraordinary Loss	3,267	2,792	2,434
Income Taxes			
Federal	1,057	824	684
State and local	109	79	101
Total income taxes	1,166	903	785
Income Before Extraordinary Loss	2,101	1,889	1,649
Extraordinary Loss from Discontinuance of Regulatory Accounting, net of tax		(2,819)	
Net Income (Loss)	\$2,101	-\$930	\$1,649
Earnings Per Common Share:			
Income Before Extraordinary Loss	\$3.46	\$3.10	\$2.74
Extraordinary Loss		(4.63)	
Net Income (Loss)	\$3.46	(\$1.53)	\$2.74
Weighted Average Number of Common Shares Outstanding (in millions)	607	609	601

Exhibit 10c: SBC Communications, Inc. Consolidated Statements of Cash Flows

Dollars in millions, increase (decrease) in cash and cash equivalents	1996	1995	1994
Operating Activities			
Net income (loss)	\$2,101	(\$930)	\$1,649
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	2,240	2,170	2,038
Undistributed earnings from investments in equity affiliates	(174)	(94)	(134)
Provision for uncollectible accounts	226	178	153
Amortization of investment tax credits	(32)	(42)	(61)
Pensions and other postemployment expenses	221	138	202
Deferred income tax expense	165	463	(124)
Extraordinary loss, net of tax		2,819	
Changes in operating assets and liabilities:			
Accounts receivable	(412)	(363)	(303)
Other current assets	(106)	33	(90)
Accounts payable and accrued liabilities	660	(186)	430
Other - net	(65)	(165)	208
Total adjustments	2,723	4,951	2,319
Net Cash Provided by Operating Activities	4,824	4,021	3,968
Investing Activities			
Construction and capital expenditures	(3,027)	(2,336)	(2,350)
Investments in affiliates	(29)	(16)	(22)
Purchase of short-term investments	(1,005)	(704)	(325)
Proceeds from short-term investments	816	587	390
Dispositions	67		141
Acquisitions	(264)	(538)	(1,182)
Net Cash Used in Investing Activities	(3,442)	(3,007)	(3,348)
Financing Activities			
Net change in short-term borrowings with original maturities of three months or less	5	(111)	463
Issuance of other short-term borrowings	209	91	36
Repayment of other short-term borrowings	(134)	(91)	(41)
Issuance of other long-term debt	209	981	345
Repayment of other long-term debt	(393)	(272)	(450)
Early extinguishment of debt and related call premiums		(465)	
Issuance of common shares			40
Purchase of treasury shares	(650)	(216)	(447)
Issuance of treasury shares	52	82	18
Dividends paid	(928)	(888)	(837)
Net Cash Used in Financing Activities	(1,630)	(889)	(873)
Net increase (decrease) in cash and cash equivalents	(248)	125	(253)
Cash and cash equivalents beginning of year	490	365	618
Cash and cash equivalents end of year	\$242	\$490	\$365

Exhibit 11a: Rand/US\$ historical exchange rates

Month	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Jan	2.36	2.09	1.99	2.38	2.56	2.56	2.78	3.07	3.41	3.55	3.64	4.64
Feb	2.09	2.08	2.08	2.46	2.54	2.54	2.82	3.12	3.45	3.56	3.75	4.45
Mar	2.03	2.08	2.15	2.54	2.61	2.65	2.88	3.18	3.46	3.60	3.93	
Apr	2.05	2.04	2.16	2.55	2.66	2.74	2.88	3.17	3.59	3.60	4.22	
May	2.20	2.02	2.21	2.68	2.65	2.80	2.85	3.18	3.63	3.66	4.38	
Jun	2.53	2.04	2.27	2.78	2.66	2.87	2.81	3.24	3.63	3.66	4.35	
Jul	2.54	2.08	2.39	2.69	2.63	2.88	2.75	3.35	3.67	3.64	4.39	
Aug	2.60	2.10	2.45	2.72	2.57	2.87	2.76	3.36	3.60	3.64	4.53	
Sep	2.32	2.07	2.45	2.79	2.57	2.84	2.80	3.41	3.56	3.66	4.50	
Oct	2.25	2.08	2.46	2.67	2.54	2.83	2.89	3.39	3.54	3.65	4.57	
Nov	2.25	2.00	2.39	2.63	2.52	2.80	3.00	3.36	3.52	3.65	4.66	
Dec	2.22	1.97	2.34	2.57	2.53	2.77	3.01	3.38	3.56	3.66	4.68	

Exhibit 11b: Graph of historical exchange rates

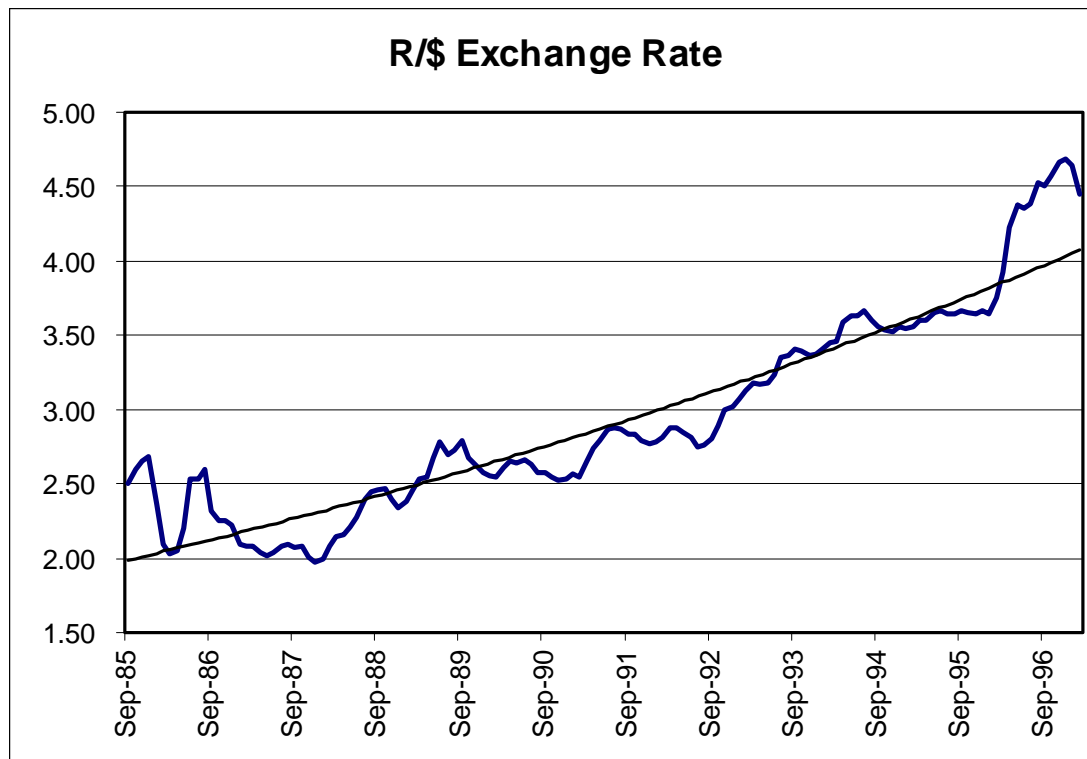


Exhibit 12: Comparable Companies

	Name	Ticker	Country	ICRG Country Credit Rating	Beta	Total Debt / Equity	PE ratio	Price to book value	Price to Cash Flow	ROE	ROA	ROI	Profitabi lity
1	Cable & Wireless	CWC	Britian	82.5	1.41		14.22					22.01	27.71
2	AT&T	T	US	86.0	0.88	0.30	29.00	6.26	17.31	21.66	8.80	11.95	9.66
3	Matav	MTA	Hungrary	77.5		0.70	27.75	5.62	12.77	22.41	12.17	14.78	19.72
4	Telemex	TMX	Mexico	69.0	1.66		18.07					11.48	21.10
5	Deutsche Telecom	DT	Germany	84.0	0.82		54.92					2.30	5.09
6	France Telecom	FTE	France	82.5		1.12	39.64	5.44	11.66	13.81	4.26	6.38	7.50
7	Telecom Itali	TI	Italy	83.0	1.19	0.52	32.03	2.50	7.04	10.68	5.85	9.37	10.92
8	Telefonica	TEF	Spain	81.0	1.19		31.86					5.77	10.46
9	Esat Telecom	ESATY	Ireland	87.5		5.48	neg	36.73	neg	(573.29)	(31.07)	(36.70)	neg
10	Tricom	TDR	Dominican Republic	69.5			9.60					1.68	3.36
11	Company de Telecom Chile	CTC	Chile	82.5	1.30		25.56					7.12	21.46
12	Telecom Denmark	TLD	Denmark	89.5	0.46		75.93					4.13	5.04
13	Philipine Telecom	PHI	Philipines	72.5	1.69							5.67	21.42
14	Telecom Argentina	TEO	Argentina	73.0	1.83		14.53					7.20	11.88
15	Hong Kong Telecom	HKT	Hong Kong	82.0	1.16		9.23					49.56	48.70
	Mean			80.1	1.2	1.6	29.4	11.3	12.2	17.1	7.8	8.2	16.0