02 Strategic Performance

Question and answer with the Chief Executive Officer, James Herbst

Huge experienced a year of solid gains, while also enhancing its management team and concluding bolt-on acquisitions and empowerment transactions. Despite challenges, the Group ended the year in a pleasing position for future successes.

JAMES HERBST *Chief Executive Officer*

While Huge has, like many South African companies, been impacted by the tough local economic environment in the year ending February 2019, Huge has produced growth in earnings, declared a dividend, taken on a new Chief Financial Officer and Chief Operating Officer, completed two bolt-on acquisitions and finalised a B-BBEE transaction. Here, Chief Executive Officer James Herbst discusses the year in review and Huge's future plans.

Q Could you please summarise the last year in the life of the Huge Group?

A We have had a year of fun, but not without its challenges: but challenges are fun.

We had an incoming Chief Operating Officer - Andy Openshaw, previously of Reunert and a new Chief Financial Officer - Samantha Sequeira, previously of Virgin Mobile. That transition is difficult and that process needs to be managed, but I'm excited about the future now that we have the requisite capacity.

The general business environment has been very tough. Our customers are predominantly SMEs and they've suffered in the tough economic climate. This last year where we've lost customers, it is not because of competition but because our customers are simply going out of business.

The subsidiary companies are generally in good shape, at a revenue level they haven't shot the lights out but they have had solid gains. Operating efficiencies have come through this year and with further technological improvements in the future, we can implement a lot more efficiencies.

The top line results have been pleasing and at the margin level I'm comfortable. All in all, the results have positioned us well for the next year and I am looking forward to it.

Q Huge didn't deliver on any significant acquisitions last year - what was the reason for that?

A Acquisitions aren't an exact science. Often pricing is incorrect, valuations are incorrect or proposals may not pass the due diligence process. If the asset is an attractive asset, there will be a lot of people competing for it.

We did engage on two significant transactions last year. After going through the processes, we had to make decisions which meant that we didn't bring them home.

It is disappointing, but our Board has a very commercial outlook and they are trying to do the right things when making an acquisition. Huge cannot buy any asset at any price – it must be the right asset, at the right price. We feel the market is disappointed by our lack of acquisitions, but to balance that, we have concluded two bolt-on acquisitions.

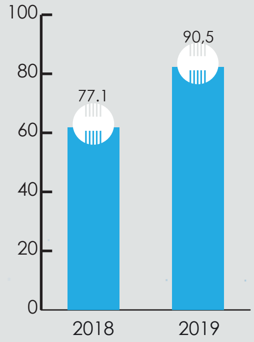
17%

increase in net profit after tax from R77.1 million to R90.5 million

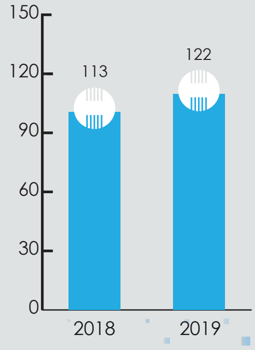
8%

increase in operating profit from R113 million to R122 million

Net profit after tax (Rm)



Operating Profit (Rm)



Q Can you give us a bit of background on those two bolt-on acquisitions and the main driver behind them?

A We engaged in two business combinations. The first is Otel, which operates in the voice over IP, internet service provider and data provider space and is similar to Huge Networks, but slightly bigger.

We were approached to invest in Otel, but upon review decided it would be better suited to a merger with Huge Networks. We did what in corporate finance terms is described as "an asset for unlisted paper swap". Otel's shareholders gave us assets and we gave them unlisted shares in Huge Networks. The result of the merger with Otel will expand our existing business and we've increased our staff compliment from 17 to 77. With the additional capacity on board, diversified risk and an increased customer real estate, the market may see revenue growth, earnings contributions and a much bigger business in the medium to long term.

In the second business combination, which was concluded after the financial year end, we acquired a controlling stake in Pansmart, a supplier of Panasonic PABXs in South Africa. The founders of that business had built it to a sustainable level over the last three years. Pansmart has a route to market and multiple customers. We also have, in Huge Telecom, a very big distribution capability, with over 750 business partners, who can now become resellers for Pansmart.

While these bolt-on acquisitions are miniscule at a Rand outflow level, their contribution to the Growing Huge Strategy going forward will be significant.

Q The market is by-and-large moving to the cloud and IP telephony – yet you've bought a PABX provider. What is the rationale for a move that some would see as going backwards?

A Cloud is an interesting concept. When you talk about the cloud, it does not mean there is no infrastructure, it just means that the infrastructure is controlled by a third party. You can provide services using third party infrastructure, or you can do so using your own. When you use your own infrastructure, it is typically on-site, *versus* third party being typically off-site. You gain access to that off-site infrastructure 'in the cloud'.

The decision to go onsite or cloud really comes down to economics. What's the cost of the infrastructure in the cloud *versus* on premises? What's the total cost of ownership, not just the infrastructure but managing that infrastructure?

We have to focus on the economics, which is why we bought Pansmart, which delivers physical infrastructure. The Pansmart offering is one of the lowest entry-level PABXs on the market. We can sell that to the SME market for R3 000. When you look at the cost of delivering the same solution through the cloud, using third party infrastructure and management, it works out more expensive.

Question and answer with the Chief Executive Officer, James Herbst (continued)

Q How does the lack of 5G spectrum impact Huge, and specifically its FST product?

A Full suite telephony (FST) uses GSM as the transmission protocol. We're the first company worldwide to deliver such a service on a fixed location basis.

We think it's going to become the norm in delivering last mile services to a fixed location and I believe it will completely substitute copper cables.

The beauty of GSM - which is a 2G application – is that it is not a big consumer of data. You only need throughput of 32kb/s to be able to pass on a voice message. This means we can sit behind the technology curve on the oldest part of the technology stack, without a significant technology risk. This makes our business model so attractive.

FST is simply a telephone line. You use a single geographic number for calling name presentation and anyone calling your number will be routed to a mobile network operator that controls that number. Underlying that number are a whole range of telephone lines which are wireless, instead of copper.

GSM doesn't require the establishment of a network. The mobile network operators have built enough towers and transmission to satisfy consumer needs and all we do is piggy-back off that infrastructure. As the mobile network operators move up the technology curve from 3G to 4G to LTE, we are provided with access to excess capacity on older technologies, which we can get a very low price. This allows us to deliver telephony solutions to SMEs at substantially reduced prices.

Q You had some technological setbacks with FST this year. How far along are you in resolving those and when can you expect to fully take it to market?

A From a technology perspective, the viability of FST has now been proven. Initially, we were faced with significant challenges and we were engaging with a single operator.
However, there are other operators able to provide the same service and what remains is to secure the commercial arrangements to be able to deliver the technology. Its public knowledge that we've had a debate with one of our suppliers but we do believe we can resolve that matter.

Q That would be the dispute with Cell C?

A Correct. In anticipation of the launch and success of FST we paid substantial amounts to Cell C for access to its network in the first 18 months of supply.
We also made substantial advance payments for future services. Due to technical challenges, FST then had to be partially withdrawn, but we had still made those payments. We consequently have an accrued right of advance payments and for the next 12 months have the luxury of not having to make any further payments. This has the effect of making Huge Telecom in particular, but also Huge Group, even more cash positive. In future, we will then look to secure arrangements where we are not required to make such significant commitments in advance.

Q Cell C dispute and tough market conditions notwithstanding, you've been able to declare a dividend this year for the first time since 2015. What has Huge done in the past year that has enabled this?

A Where you are building a company and investing in things like working capital, inventory in particular, there is less cash to distribute.
We have now solved that for our shareholders, and we are very pleased that we can pay a dividend this year. I have been asked if that would become a policy, but I think we do everything at Huge in context. The dividend is not cast in stone, but next year if we are cash generative and have excess cash, we will look to distribute that to our shareholders. We believe our shareholders should share in the rewards of our efforts on an ongoing basis.

Q You've done a broad-based black economic empowerment transaction in the last year, can you provide more details on that and how both parties are going to benefit from that in the long term?

A Our view as a board is that transformation is critical and must be done in a sustainable manner. The B-BBEE transaction we have concluded has been done in an economically sensible manner.

We have divested and reduced our shareholdings in two wholly-owned subsidiaries - Huge Soho and Huge Cellular – which have now become portals for enterprise development and supplier development. We will capacitate these entities and help to grow them with our B-BBEE partner – Windfall, which is controlled by Vincent Mokholo and Sylvia Mokholo. Vincent is a non-executive director of Huge Group and we've worked with him for over 20 years. Doing business is about trust and we have a long relationship with our B-BBEE partners which embodies trust, loyalty and good business practice. We think that these transactions will add significant value to both Huge and to Windfall.

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Otel Transaction

Huge Networks concluded a transaction with Otel which contemplated the acquisition by Huge Networks of the businesses of Otel Communications and Otel Business and which came into effect on 27 February 2019. The purchase consideration for the Otel Transaction was settled in ordinary shares of Huge Networks, such that, after the issue of shares of Huge Networks, Huge Telecom's shareholding in Huge Networks decreased from 100% to 50.03% (the **Otel Transaction**).

The Otel Transaction allows Huge to progress the Growing Huge Strategy by scaling its operations and growing Huge's customer real estate. The Otel Transaction expands the national reach and footprint of Huge, allows Huge Networks to become a more substantial provider of end-to-end ICT services, provides Huge Networks with an opportunity to enter new customer segments and leverage economies of scale. Going forward, Huge Networks will be well-positioned to capitalise on the further expansion of the ISP and ICT service provider industry through various organic and acquisition growth strategies.

Pansmart Transaction

Huge Group acquired a 50.24% interest in Pansmart Proprietary Limited (**Pansmart**) with effect from 13 May 2019. The acquisition provides Huge with control over an authorised distributor of Panasonic's voice, video and CCTV products.

Pansmart is a strong challenger in the South African PABX market, with a full technical and sales competency. The hybrid PABXs that Pansmart distributes include embedded analogue voice ports which provide simple and cost effective PABX and GSM Voice solutions. Pansmart's Panasonic PABX and Huge Telecom's GSM-based FST offering is a powerful connectivity combination. The acquisition expands upon Huge Telecom's customer real estate and provides a new brand offering to Huge Group's portfolio of products.

Windfall B-BBEE Transactions

Huge understands the importance of B-BBEE in the national context and the value of transformation in improving the socio-economic challenges prevalent in the country. Improvement in the B-BBEE status of Huge remains a key strategic objective of the Growing Huge Strategy. During the prior reporting period, Huge implemented the B-BBEE Compliance Plan with the aim of its major subsidiary companies into compliance with the ICT Sector Charter.

As part of the B-BBEE Compliance Plan, the Group concluded ownership transactions with Windfall 111 Properties Proprietary Limited (**Windfall**) in respect of both Huge Cellular and Huge Soho. Windfall is 60% black women owned and has a long-standing relationship with Huge.

It is anticipated that these entities will be able to deliver significant empowerment through various supply contracts that Huge anticipates will be concluded in the financial year ended 2020. The Group looks forward to reporting on growth in this area in its next integrated report.