

CREDIT OPINION

27 March 2023

Update

Send Your Feedback

RATINGS

Telkom SA SOC Limited

Domicile	Pretoria, South Africa
Long Term Rating	Ba2
Type	LT Corporate Family Ratings
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

Contacts

Lisa Jaeger +971.4.237.9659
 VP-Senior Analyst
 lisa.jaeger@moodys.com

Yara Abdelgelil +971.4.237.9509
 Associate Analyst
 yara.abdelgelil@moodys.com

Rehan Akbar, CFA +971.4.237.9565
 Senior Vice President
 rehan.akbar@moodys.com

Telkom SA SOC Limited

Update to credit analysis

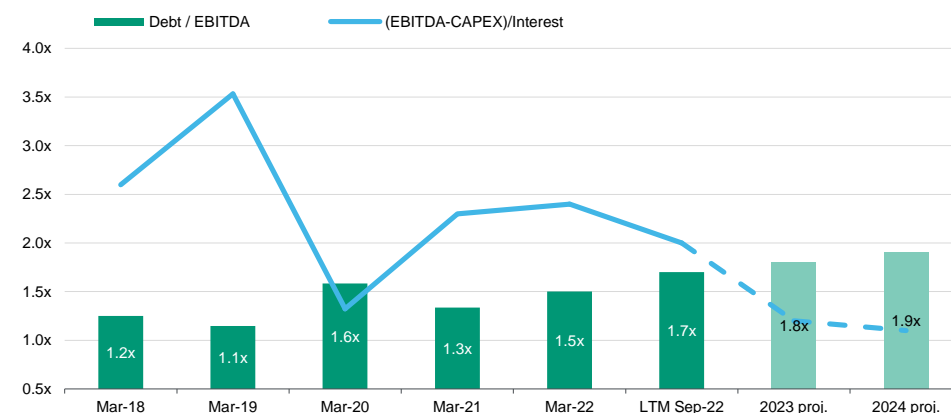
Summary

[Telkom SA SOC Limited's](#) (Telkom) Ba2 corporate family rating and its Aa1.za national scale rating (NSR) reflect our view of the fundamental credit quality of Telkom, represented by its Baseline Credit Assessment (BCA) of ba2, combined with our assumptions of high default dependence with- and moderate support from the South African government. We classify Telkom as a government related issuer (GRI) because it is 40.5% owned by the [Government of South Africa](#) (Ba2 stable). Despite having strong credit metrics and adequate liquidity, Telkom derives all of its revenue from South Africa and therefore its credit standing is strongly correlated to the economic and regulatory environment in the country. The low growth environment and intense competition between mobile network operators is a growth constraint to Telkom.

Telkom's BCA of ba2 is supported by (1) the company's leading market position in South Africa's fixed-line business and operator of the largest fibre network in the country; and (2) prudent financial policies and healthy credit metrics with debt to EBITDA of 1.7x as of the twelve months ending September 2022 (September 2022 LTM). The rating is constrained by (1) operational concentration in South Africa and exposure to the country's economic, social, political, legal and regulatory environment; (2) the company's position as the third largest operator in a highly competitive South African mobile market; and (3) low growth prospects with continued, albeit slowing decline of fixed line business and mature mobile market.

Exhibit 1

We expect Telkom's credit metrics to remain healthy despite some weakening



[1] This represents Moody's forward view, not the view of the issuer; and unless noted in the text, does not incorporate significant acquisition and divestitures

Source: Moody's Investors Service

Credit strengths

- » Successfully completed transition towards integrated telecommunications business model to mitigate declining fixed voice revenue
- » Leading market position in South Africa's fixed-line business, with the largest fibre network in South Africa based on fibre kilometres
- » Healthy credit metrics and adequate liquidity

Credit challenges

- » Geographic concentration in South Africa
- » Continued, albeit slower decline of fixed line business
- » Relatively small mobile operator in highly competitive and mature South African mobile market

Rating outlook

The stable outlook reflects the stable outlook on the sovereign bond rating of the government of South Africa. The stable outlook also reflects Telkom's good track record in adhering to its prudent financial policies and our expectation that Telkom will be able to maintain adequate credit metrics and liquidity despite low growth prospects.

Factors that could lead to an upgrade

Telkom's ratings are capped by the government bond rating of South Africa, therefore an upgrade will only be considered if the sovereign ratings of South Africa are upgraded. Following an upgrade of the sovereign ratings of South Africa, we would consider upgrading Telkom's ratings if liquidity remains adequate and Moody's adjusted debt/ EBITDA sustainably remains below 2.0x and EBITDA is on a stable to slowly growing trajectory.

Factors that could lead to a downgrade

Telkom's ratings are likely to be downgraded in case of a downgrade of South Africa's sovereign ratings, although Moody's will continue to monitor resilience of Telkom's credit profile against macro-economic shocks. A downgrade would also be considered if Telkom's liquidity profile weakens, debt/EBITDA exceeds 3.0x on a sustained basis or retained cash flow/total debt falls below 20% on a sustained basis.

Key indicators

Exhibit 2

Key Indicators for Telkom SA SOC Limited^{[1][2][3]}

	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	LTM Sep-22	FY 2023(f)	FY 2024(f)
Revenue (ZAR Billion)	39.7	41.8	43.0	43.2	42.8	42.6	42.5	42.8
Debt / EBITDA	1.2x	1.1x	1.6x	1.3x	1.5x	1.7x	1.8x	1.9x
RCF / Debt	49.3%	50.9%	39.6%	59.9%	58.4%	50.3%	44.1%	43.8%
(EBITDA - CAPEX) / Interest Expense	2.6x	3.5x	1.3x	2.3x	2.4x	2.0x	1.2x	1.1x

[1] All figures and ratios are calculated using Moody's estimates and standard adjustments.

[2] Periods are Financial Year-End unless indicated. LTM = Last Twelve Months.

[3] Moody's Forecasts (f) or Projections (proj.) are Moody's opinion and do not represent the views of the issuer.

Source: Moody's Investors Service

Profile

Telkom is the leading South African fixed-line operator and the third incumbent mobile operator, controlling around 900,000 fixed telephone access lines, most of which are connected to digital exchanges, and has 18 million active mobile subscribers in South Africa, making it the third largest mobile operator in the country by number of subscribers. As of 30 September 2022, the company had the largest national fibre network across South Africa. Telkom operates across four segments: Consumer (mobile, fixed-line

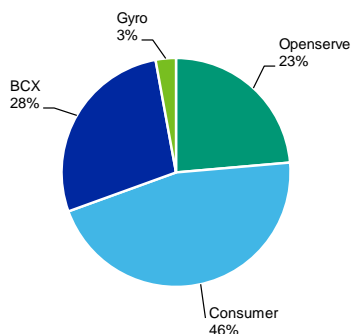
This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody.com> for the most updated credit rating action information and rating history.

and broadband), Business Connection Group (BCX, offering information and communication technology services, ICT), Openserve (wholesale connectivity), Swiftnet (masts and towers) and Gyro (property portfolio).

Telkom is listed on the Johannesburg Stock Exchange (JSE) and is 40.5% owned by the South African government, 10.5% by the Public Investment Corporation, a South African state-owned investment management company, and the remaining 49.0% is free float, as of 30 September 2022.

Exhibit 3

Revenue by business segment September 2022 LTM

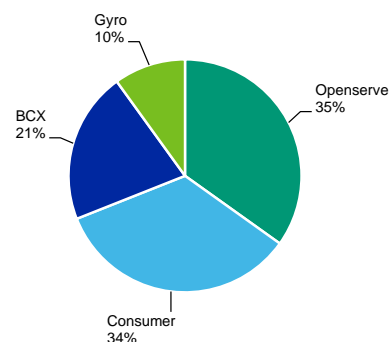


Note: Includes revenue from external customers and intersegmental operating revenue, before intracompany eliminations

Sources: Company information, Moody's Investors Service

Exhibit 4

EBITDA by business segment September 2022 LTM



Note: Based on company reported EBITDA, before intracompany eliminations and excluding other losses

Sources: Company information, Moody's Investors Service

Detailed credit considerations

Geographic concentration in South Africa

Telkom's revenue and EBITDA are exclusively generated in South Africa, which exposes the company to the economic, political, social, legal and regulatory environment of the country. Growth of the South African economy remains structurally weak, despite some recovery from the pandemic in 2021. We expect growth of 1.8% for 2022 and medium term growth of only around 1.0-1.5% due to constraints from a malfunctioning labour market, decaying infrastructure and slow progress on economic and social reforms. Telkom's revenue remained stable and Moody's adjusted EBITDA grew by 13.6% during the height of the Covid-19 pandemic over financial year 2021 (FY2021) that ended in March 2021, however since then, both revenue and EBITDA have been declining. During FY2022, revenue and EBITDA declined by 1.1% and 1.4% against a year earlier and this trend continued over the six months that ended in September 2022 (1H23) with revenue and EBITDA down 0.7% and 14.4% respectively, against the same period a year earlier.

The decline in Telkom's revenue and EBITDA over 1H23 was primarily driven by weak performance of the Consumer segment, which registered a decline in revenue of 2% against a year earlier, while costs increased by 6%. Revenues declined despite a continued growth in mobile subscribers because average revenue per user (ARPU) continued to fall under competitive pressure and as consumers see their disposable incomes decline from inflation.

In March 2022, the South African telecoms regulator ICASA concluded a spectrum auction that had been delayed for several years. The conclusion of the auction provides more certainty to operators and secures spectrum that had been allocated on a temporary basis during the pandemic, however the new spectrum is unlikely to lead to material growth for South African mobile network operators. Telkom obtained spectrum bands below 1000 megahertz, which offers better indoor coverage as well as some high frequency bands that can be used to roll out 5G.

Successful transition to integrated telecommunications business model

Over time Telkom's business model has become increasingly diversified and integrated (see exhibit 5). To offset the steady decline in demand for fixed voice services, which used to be Telkom's main product, the company embarked on a turnaround strategy in 2013 to broaden its service offering. After completion of the strategic turnaround, Telkom remains the leader in fixed telephony and broadband

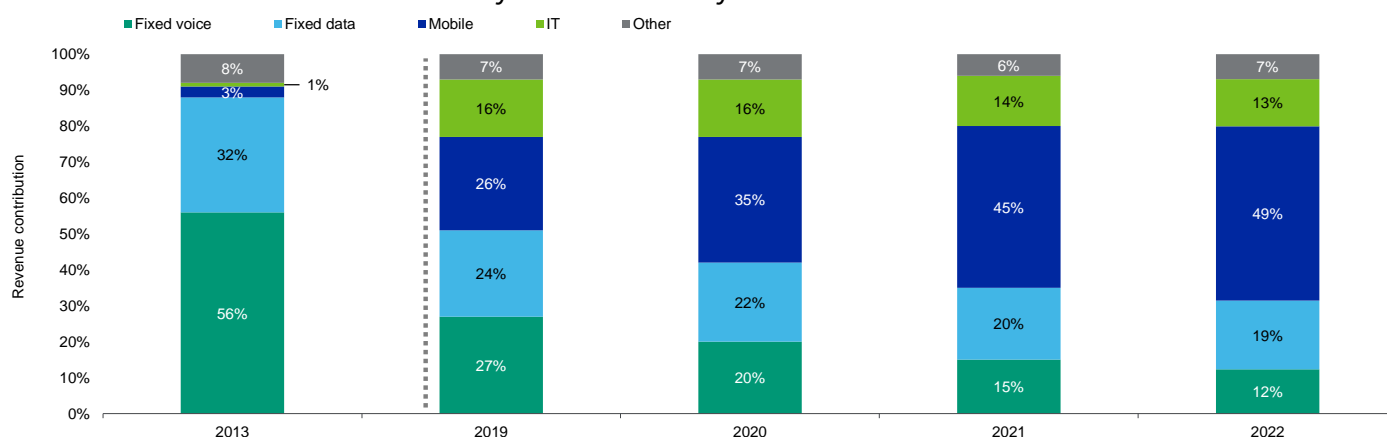
in South Africa, but the company has also built out a sizeable mobile service offering in its consumer division and added enterprise ICT services for businesses and public sector entities through the acquisition of BCX in 2015. Its ICT services include hosting, managed solutions, cloud and data center services. Telkom also has an infrastructure business, including its wholesale broadband network in the Openserve division, Gyro, its property investment and property services business and Swiftnet, its masts and towers portfolio. The infrastructure businesses derive a substantial portion of their revenue from leasing network and tower capacity to other mobile operators and third party clients.

The integrated business model has allowed Telkom to successfully diversify its income streams away from the declining fixed line voice business and positions the company well as a convergent telecom operator. Convergent offerings allow the company to serve a wider range of customers and to provide bundled packages with opportunities to upsell and increase customer loyalty.

Nevertheless, revenue growth has been slow over the past five years, at an average rate of just 0.9% per year from financial year ending March 2017 to March 2022 and for the six months ending September 2022, revenue declined by 0.7% from the same period a year earlier. Moody's adjusted EBITDA is 6% lower for the twelve months ending September 2022 than it was in March 2018. This slow revenue growth and decline in profitability is driven by the combination of continued decline of Telkom's fixed voice service, some cyclical in the BCX business and a highly competitive and relatively mature mobile market in South Africa that makes it difficult to grow this business faster than the fixed voice business is declining.

Exhibit 5

Evolution of Telkom's revenue mix from financial year 2013 to financial year 2022



Sources: Telkom, Moody's Investors Service

After rapid growth of mobile business, future growth prospects are lower in the competitive and mature South African mobile market

The mobile business, comprising both voice and data services, has become Telkom's primary revenue driver and accounted for 51% of group revenue for the September 2022 LTM period. Telkom's mobile business has in the past grown rapidly, from 1.8 million subscribers in March 2014, generating around ZAR350 million in revenue to 18.0 million subscribers and ZAR21.5 billion of revenue for the twelve months ending September 2022. Telkom was able to generate this rapid growth despite competition from three larger, more established mobile operators Vodacom (majority owned by [Vodafone Group plc](#), Baa2 stable), [MTN Group Limited](#) (Ba2 stable) and Cell C. Telkom overtook Cell C in terms of subscriber numbers in 2020, becoming the third largest mobile operator in South Africa. Telkom's market share however still significantly lags behind the 30% market share of the second largest operator MTN and its profitability is also significantly lower at a mobile business EBITDA margin of 23% for the six months ending September 2022 against margins generally around 40% for MTN's and Vodacom's South African operations. We expect growth of the mobile segment in South Africa will slow over the next years as the mobile market is mature, as indicated by a penetration rate of 162% as of 2020 according to the World Bank, meaning there are 162 mobile subscriptions for every 100 residents, which is amongst the highest levels in the world. Over the six months to September 2022, subscriber growth continued to be strong at 10.9% against the same period a year earlier, however this was accompanied by a decline in ARPU of 5.0%, indicating pressure to reduce prices in order to grow subscriber numbers.

Focus on cost savings and network commercialization

For profitability to improve, efficiencies and cost savings are crucial. Telkom is focussed on streamlining and has significantly reduced its workforce in recent years. Over the six months ending September 2022, Telkom's EBITDA margin dropped to 24.1% from 28.0% a year earlier. This drop in profitability was mainly driven by weaker mobile margins, due to a continued decline in ARPU and the company's focus on expanding its post-paid customer base, which in turn increased the upfront cost of acquiring handsets. Margins were also impacted by the increased cost of operating diesel generators as a back-up to the electricity network in times of load-shedding.

We expect that through its focus on cost-savings, Telkom will be able to stabilize its margin over the next 12-18 months. A new roaming agreement with MTN concluded in 2021 will also help to reduce roaming costs and improve network coverage.

With growth of the mobile business expected to slow down, Telkom is focussing on cementing its leadership in broadband/ fixed data, which contributes to revenue across its Consumer, BCX and Openserve divisions and which accounts for most of the EBITDA generated by the Openserve division. Openserve accounted for 35% of Telkom's EBITDA for the September 2022 LTM period and therefore already constitutes a substantial part of the company's profitability.

Telkom has the largest fibre and broadband network across South Africa and continued investment in the network is one of Telkom's key priorities, accounting for 34% of total investments during the six months ending September 2022. During this period, the company increased homes passed with fibre by 36% to 961,000 compared to a year earlier and increased the number of homes connected by 34% to 443,000. Telkom sees particular demand growth from other carriers for use of its strong backhaul capacity. As Telkom continues its investments in the network and mobile customers' demand for speed and data consumption increases, we expect that demand from other mobile carriers for Telkom's network will continue to grow strongly. At the same time the decline in demand for fixed voice services will level off as the contribution to Telkom's revenues has already reduced substantially. The combination of growth in fixed data and slower decline of fixed voice should over the next 2-3 years lead to a stabilization and eventual growth of revenue and EBITDA from Openserve.

Telkom is in the process of monetization of its Swiftnet mast and towers portfolio. The company's board of directors approved a full or partial disposal of the mast and towers business. The company launched a sales process in the end of 2022 and expects to receive offers during the first half of 2023. However, the sale, if happens, may not necessarily lead to deleveraging, if Telkom has to enter operating leases to keep using the towers. Telkom is already commercializing its tower portfolio with an average colocation rate of 1.55x, meaning it is renting out space on a significant number of its towers to other mobile network operators or other third parties. While below the international target norm of 2x, the colocation rate is in line with pan-African and emerging markets independent tower company [IHS Holding Limited](#) (B3 stable) and an adequate ratio for a tower portfolio in growth stage.

Over the longer term Telkom is also considering selling a minority stake in its Openserve business and for this purpose completed an operational separation of the business from the rest of Telkom during the six months that ended September 2022.

Financial credit metrics have weakened but remain adequate due to operating pressures

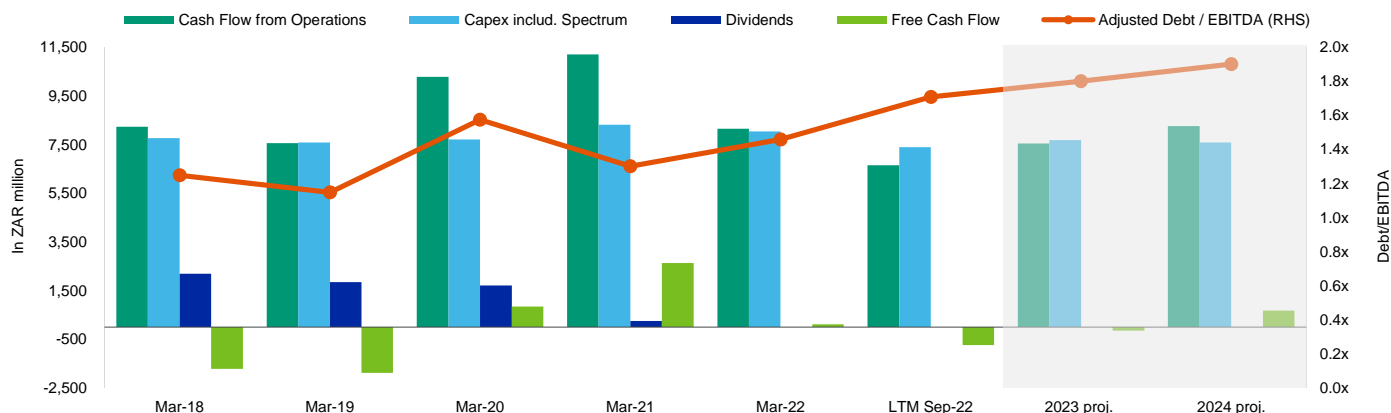
Telkom has conservative financial policies with target net leverage of around 1.5x and a strong track record of complying with its financial targets. For the September 2022 LTM period net leverage stood at 1.7x. This is in line with Moody's adjusted leverage of 1.7x, which we view as adequate for Telkom. We expect leverage to remain around 1.8x over the next 12-18 months. The possible sale of Swiftnet and partnership plans for Openserve could provide Telkom with additional sources of cash flow and flexibility to keep leverage low.

Telkom suspended its dividend policy for the past 3 years and plans to resume the policy by the end of FY2023, however we expect the company to remain prudent when allocating cash flow between shareholder returns, investments and adhering to its leverage target.

Telkom also has the option to be more prudent in its capital spending over the next 12 months and could reduce spending to the lower end of its market guidance of 16% to 18%, but we expect the company will continue to make capital investments a priority over dividends for the coming years.

Exhibit 6

Cash flow generation has weakened, leading to a slight increase in leverage



[1] Cash flow from operations shown excluding dividend payments

[2] This represents Moody's forward view, not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

Source: Moody's Investors Service

South African government support and dependence assumptions result in no rating uplift

Moody's default dependence assessment reflects the degree of correlation of a government-related issuer, such as Telkom, and its supporting government to being jointly susceptible to adverse circumstances that simultaneously move them closer to default. The "high" default dependence assumption reflects our view that both the South African government and Telkom's performance are highly correlated to the general business cycle in South Africa. In addition, it factors the moderate link between the government and Telkom, given the firm's partial privatisation during the past decade. Despite its 40.5% stake in Telkom, the South African government has no board representation, which limits its influence over the strategic direction of the company.

The "moderate" support assessment reflects the strategic role of the company in expanding telecommunications links to citizens in rural areas and in poorly serviced townships adjacent to large urban centres. The assessment also takes into account the government's moderate interventionist tendencies. Any reduction in government ownership could weaken our support assumption, but will not impact the overall rating position, given Telkom's standalone credit profile as reflected by the ba2 BCA, which is currently in line with that of the Government of South Africa.

ESG considerations

Telkom SA SOC Limited's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 7

ESG Credit Impact Score

CIS-2
Neutral-to-Low

NEGATIVE IMPACT : : POSITIVE IMPACT

For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

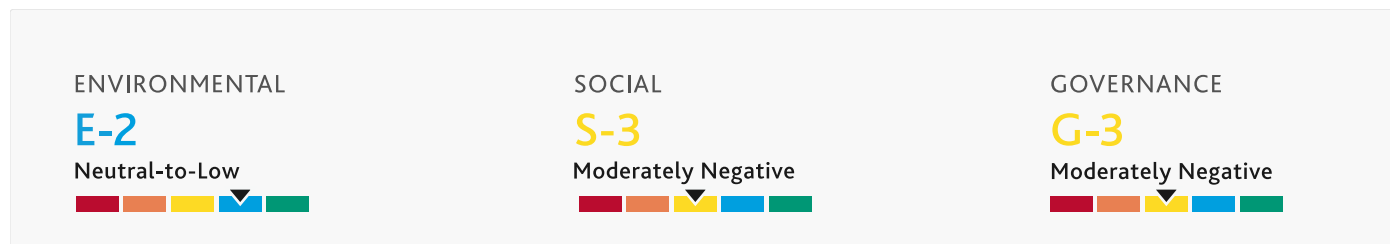
Source: Moody's Investors Service

Telkom's ESG Credit Impact Score is Neutral-to-Low (CIS-2), meaning ESG attributes have a low credit impact on Telkom's rating. This factors in Telkom's low environmental risk exposure and moderate social and governance risks, which are offset by the company's

conservative financial policy and strong management track record. The low credit impact is also caused by the rating being capped by South Africa's sovereign rating.

Exhibit 8

ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

The company's exposure to environmental risks is low and in line with the overall industry. Telkom is mostly focussed on energy efficient projects to reduce energy consumption.

Social

Telkom faces moderately negative social risks as it is exposed to well entrenched labour unions with rigid employee regulations and changing demographic and societal trends towards the use of telecom related technology. This is partially mitigated by Telkom's good track record over the past few years in reducing its overall work force, in particular in its declining fixed voice business and of successfully growing mobile voice and data businesses to offset declining fixed voice revenues. Data security and data privacy issues are prominent in the sector. Telecommunications providers exchange large amounts of data, and a breach could cause legal, regulatory or reputation issues. In addition, a breach could result in increased operational costs to mitigate cyberattacks and reduce exposure to the loss of private data. Electromagnetic radiation (for example, from mobile antennas or mobile handsets) has repeatedly been said to be potentially harmful to the environment and health. While the need for higher mobile data speeds will increase electromagnetic radiation, we do not see it as a significant environmental risk for global telecommunication providers, given the existing regulatory radiation limits and ongoing technology improvements.

Governance

Telkom faces moderate governance risks as the government of South Africa is the largest shareholder with 40.5% ownership. The risk of government interference is low as the government has no board representation and has no track record of active interference in the company's management. Telkom has conservative financial policies and a good track record in adhering to these.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Liquidity analysis

Telkom has adequate liquidity. As of 30 September 2022, the company's internal liquidity sources included ZAR2.5 billion of cash and ZAR16.0 billion of operating cash flow, which we project the company to generate through March 2024. In addition, Telkom arranged a ZAR2.0 5-year term loan in December 2022. Together, this should be sufficient to cover capital spending (including lease payments) of ZAR14.2 billion and debt maturities of ZAR5.2 billion through March 2024.

In addition, the company had ZAR1.5 billion of available long-term committed revolving credit facilities. Some of Telkom's facilities include financial covenants, including interest cover and net leverage, which the company will be able to meet comfortably.

Rating methodology and scorecard factors

The principal methodology used in rating the company was our Telecommunications Service Providers rating methodology published in September 2022. The 1 notch difference between the grid indicated outcome of Ba1 and the Ba2 rating is due to operational concentration in South Africa and the company's weakening profitability.

Exhibit 9

Rating factors

Telkom SA SOC Limited

Scorecard Factors

Telkom SA SOC Limited

Telecommunications Service Providers Industry Scorecard [1][2]

Current
LTM 9/30/2022Moody's 12-18 Month Forward View
As of 1/4/2023 [3]

Factor 1 : Scale (12.5%)	Measure	Score	Measure	Score
a) Revenue (USD Billion)	\$2.7	B	\$2.7	B
Factor 2 : Business Profile (27.5%)				
a) Business Model, Competitive Environment and Technical Positioning	B	B	B	B
b) Regulatory Environment	Baa	Baa	Baa	Baa
c) Market Share	Ba	Ba	Ba	Ba
Factor 3 : Profitability and Efficiency (10%)				
a) Revenue Trend and Margin Sustainability	Baa	Baa	Baa	Baa
Factor 4 : Leverage and Coverage (35%)				
a) Debt / EBITDA	1.7x	A	1.8x	A
b) RCF / Debt	50.3%	Aa	44%	A
c) (EBITDA - CAPEX) / Interest Expense	2.0x	Ba	1.2x - 1.5x	B
Factor 5 : Financial Policy (15%)				
a) Financial Policy	Baa	Baa	Baa	Baa
Rating:				
a) Scorecard-Indicated Outcome		Baa3		Ba1
b) Actual Rating Assigned				Ba2

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations

[2] As of 9/30/2022(L); Source: Moody's Financial Metrics™

[3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures

Source: Moody's Investors Service

Ratings

Exhibit 10

Category	Moody's Rating
TELKOM SA SOC LIMITED	
Outlook	Stable
Corporate Family Rating	Ba2
NSR Corporate Family Rating	Aa1.za

Source: Moody's Investors Service

Appendix

Exhibit 11

Moody's-Adjusted Debt Reconciliation for Telkom SA SOC Limited^{[1][2]}

(in ZAR Millions)	FYE Mar-18	FYE Mar-19	FYE Mar-20	FYE Mar-21	FYE Mar-22	LTM Ending Sep-22
As Reported Debt	9,427	10,241	16,782	15,839	17,306	18,825
Pensions	1,966	752	0	255	0	0
Operating Leases	3,312	3,546	0	0	0	0
Moody's-Adjusted Debt	14,705	14,539	16,782	16,094	17,306	18,825

[1] All figures are calculated using Moody's estimates and standard adjustments.

[2] Periods are Financial Year-End unless indicated. LTM = Last Twelve Months.

Source: Moody's Financial Metrics TM

Exhibit 12

Moody's-Adjusted EBITDA Reconciliation for Telkom SA SOC Limited^{[1][2]}

(in ZAR Millions)	FYE Mar-18	FYE Mar-19	FYE Mar-20	FYE Mar-21	FYE Mar-22	LTM Ending Sep-22
As Reported EBITDA	10,580	10,706	9,391	11,614	11,885	11,029
Pensions	84	87	37	35	-8	-8
Operating Leases	1,104	1,182	0	0	0	0
Unusual	-59	700	1,187	395	0	0
Non-Standard Adjustments	70	-2	-11	0	0	0
Moody's-Adjusted EBITDA	11,779	12,673	10,604	12,044	11,877	11,021

[1] All figures are calculated using Moody's estimates and standard adjustments.

[2] Periods are Financial Year-End unless indicated. LTM = Last Twelve Months.

Source: Moody's Financial Metrics TM

Exhibit 13

Peer comparison^{[1][2]}

(in US millions)	Telkom SA SOC Limited			MTN Group Limited			Millicom International Cellular S.A.		
	Ba2 Stable			Ba2 Stable			Ba1 Stable		
	FYE Mar-21	FYE Mar-22	LTM Sep-22	FYE Dec-20	FYE Dec-21	LTM Jun-22	FYE Dec-20	FYE Dec-21	LTM Sep-22
Revenues	\$2,656	\$2,884	\$2,701	\$10,967	\$12,304	\$12,669	\$4,171	\$4,617	\$5,854
EBITDA	\$740	\$801	\$699	\$4,587	\$5,445	\$5,502	\$1,668	\$1,845	\$2,311
Total Debt	\$1,090	\$1,184	\$1,047	\$9,921	\$8,071	\$8,750	\$6,710	\$8,912	\$7,890
Cash & Cash Equivalents	\$339	\$222	\$139	\$2,110	\$2,474	\$2,474	\$875	\$895	\$937
EBITDA Margin	27.9%	27.8%	25.9%	41.8%	44.3%	43.4%	40.0%	40.0%	39.5%
(EBITDA-CAPEX) / Interest Expense	2.3x	2.4x	2.0x	2.6x	3.0x	2.5x	1.2x	1.6x	1.6x
Debt / EBITDA	1.3x	1.5x	1.7x	1.9x	1.6x	1.7x	4.0x	4.8x	3.4x
FCF / Debt	11.0%	-5.5%	-9.9%	10.1%	18.7%	5.0%	-1.8%	-0.5%	0.2%
RCF / Debt	59.9%	58.4%	50.3%	34.1%	44.8%	38.4%	10.8%	10.9%	16.1%

[1] All figures & ratios calculated using Moody's estimates & standard adjustments.

[2] FYE = Financial Year-End. LTM = Last Twelve Months. RUR* = Ratings under Review, where UPG = for upgrade and DNG = for downgrade. Source: Moody's Financial Metrics TMSource: Moody's Financial Metrics TM

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REPORT NUMBER 1352638