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## Research Update:

# Danish Telecom Operator TDC A/S 'BBB-/A-3' Ratings Affirmed On Dividend Cut; Outlook Stable

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## Research Update:

# Danish Telecom Operator TDC A/S 'BBB-/A-3' Ratings Affirmed On Dividend Cut; Outlook Stable

## Overview

- On Jan. 27, 2016, Danish telecom network operator TDC A/S announced that it expects its EBITDA to decline by about 10% in 2016 and that it will suspend dividend payments until 2017.
- We think that the dividend cut sufficiently balances the impact of lower EBITDA on credit ratios in the near term.
- We are therefore affirming our ratings on TDC at 'BBB-/A-3'.
- The stable outlook on TDC reflects our expectation that the company will achieve approximately flat EBITDA in 2017 and that it will maintain debt to EBITDA at or below 3.5x and funds from operations to debt sustainably above 20%.

## Rating Action

On Feb. 2, 2016, Standard & Poor's Ratings Services affirmed its long- and short-term corporate credit ratings on Danish telecommunications services provider TDC A/S at 'BBB-/A-3'. The outlook is stable.

At the same time, we affirmed our issue ratings on TDC's senior unsecured debt at 'BBB-' and on its junior subordinated debt at 'BB'.

## Rationale

The affirmation follows TDC's announcement that it expects its group EBITDA to decline to about Danish kroner (DKK) 8.8 billion in 2016 as well as its decision to suspend dividend payouts in 2016 and reduce them significantly in 2017 compared with payouts in 2015. In our view, the dividend reductions mitigate the effect of lower EBITDA in the near term and credit metrics remain adequate for the current rating. We estimate that TDC will maintain debt to EBITDA, as adjusted by Standard & Poor's, at about 3.5x in 2016-2017 and funds from operations (FFO) to debt at 21%-24% in 2016-2017, which is in line with our previous forecast.

TDC's mobile products continue to face fierce competition in the domestic market, particularly in its business-to-business (B2B) division, but also in the business-to-consumer (B2C) segment. These developments have recently led to a sharp decrease in revenues and EBITDA. In 2015, TDC's B2C and B2B EBITDA declined by about 6% and about 16%, respectively. TDC and a number of other

operators recently raised selected price points in the market, but these are still at a lower level than prices charged to a material share of TDC's client base. As a result, we think the average revenue per user (ARPU) will further decline from current levels and we do not expect a material stabilization of market conditions until 2017. In addition, we observe headwinds in selected other sub-segments, such as fixed line broadband for public, enterprise, and small and midsize business customers where intense competition also continues to weigh on ARPUs.

Aside from these considerations, TDC's business risk profile continues to be supported by its position as the leading telecoms provider in Denmark's residential customer segment, its well-invested mobile network, and its ownership of Norwegian cable operator Get. We think that TDC's ownership of Get gives it additional scale, diversification, and growth opportunities in the less competitive Norwegian market. In our view, another positive aspect for TDC's business risk is its ownership of both the leading domestic copper and cable fixed-line networks. Other weaknesses include TDC's limited geographic diversification, a relatively small customer base, and our forecast of declining revenues and EBITDA in Denmark through 2017.

We derive our assessment of TDC's financial risk profile primarily from the company's increased debt burden after the acquisition of Get, and from expected steep declines in EBITDA and free cash flow as a result of the current weakness in TDC's domestic market. Nevertheless, in our base case, we forecast that communicated cuts in shareholder distributions to zero in 2016 and to about DKK 0.8 billion in 2017 will help to stabilize debt to EBITDA, as adjusted by Standard and Poor's, at about 3.5x in the next 18 months. We project that these measures will also support relatively robust discretionary cash flow (DCF) generation, with adjusted DCF to debt of more than 6% in the next 24 months.

Our base case assumes:

- Revenue decline of 3%-5% in 2016, principally caused by further contraction in B2C and B2B revenues in Denmark, improving to about flat revenues in 2017.
- Adjusted EBITDA margins narrowing by about 2.5 percentage points to about 38%-40% in 2016 and 2017, resulting from significant EBITDA declines in TDC's Danish operations.
- Capital expenditures, including payments for mobile licenses, of about DKK4.5 billion-DKK4.9 billion in 2016, then decreasing moderately in 2017.
- No dividend payments in 2016, in line with TDC's guidance, and shareholder pay-outs of about DKK0.8 billion in 2017.
- DKK200 million in coupon payments on TDC's hybrid debt.
- Some spending on small bolt-on mergers and acquisitions.

Based on these assumptions, we arrive at the following credit measures:

- Adjusted debt to EBITDA of about 3.5x in 2016 and 2017, after 3.4x in 2015, and adjusted FFO to debt of 21%-24% in 2016-2017.
- Adjusted free operating cash flow (FOCF) to debt of about 8% in 2016,

strengthening to 8%-9% in 2017, and DCF to debt of 6%-9% in 2016 and 5%-7% in 2017.

## **Liquidity**

The short-term rating is 'A-3'. We assess TDC's liquidity as adequate because we expect that liquidity sources will cover uses at least by 1.2x over the 12 months from Jan. 1, 2016. We think that TDC's risk management aims at ensuring (what we assess as) adequate, though not necessarily strong liquidity at all times.

As of Jan. 1, 2016, principal liquidity sources over the ensuing 12 months include:

- Our forecast cash balances of about DKK350 million.
- An undrawn committed unsecured revolving credit facility of €500 million (about DKK3.7 billion) due in September 2020, and availability under other committed lines of about €175 million (about DKK1.3 billion).
- Annual FFO of about DKK6.6 billion-DKK6.9 billion.

As of Jan. 1, 2016, principal liquidity uses over the ensuing 12 months include:

- Capital expenditures of about DKK4.5 billion-DKK4.9 billion.
- Coupon payments on TDC's hybrid debt of DKK200 million in 2016.

We also note a large upcoming debt maturity of about DKK6.0 billion in February 2018.

## **Outlook**

The stable outlook on TDC reflects our view that the difficult market conditions in Denmark will stabilize in the next 18 months and that market prices will not further deteriorate materially from current levels. We think that this will allow TDC to achieve broadly flat EBITDA in 2017 compared with 2016. This, coupled with committed reductions in dividend payments, will enable it to maintain adjusted debt to EBITDA at or below 3.5x, FFO to debt sustainably above 20%, and FOCF to debt at about 8%-10%.

## **Downside scenario**

We could consider a downgrade if TDC's operating performance deteriorates more than we currently expect, for example by visibly deviating from the path to achieving stable EBITDA in 2017, causing Standard & Poor's-adjusted debt to EBITDA to rise sustainably above 3.5x, FFO to debt to fall below 20%, or FOCF to debt to weaken to less than 8% over a protracted period.

## **Upside scenario**

We think that rating upside is limited at this stage. We could consider upgrading TDC if domestic market conditions and operations improve more rapidly and significantly than we currently expect, combined with a financial

policy that targets Standard & Poor's-adjusted debt to EBITDA of sustainably less than 3.0x and FOCF to debt sustainably above 10%.

## Ratings Score Snapshot

Corporate Credit Rating: BBB-/Stable/A-3

Business risk: Satisfactory

- Country risk: Very Low
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: bbb-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable ratings analysis: Neutral (no impact)

## Related Criteria And Research

- General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Industrials: Key Credit Factors For The Telecommunications And Cable Industry, June 22, 2014
- General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- General Criteria: Methodology And Assumptions: Assigning Equity Content To Corporate Entity And North American Insurance Holding Company Hybrid Capital Instruments, April 1, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Criteria Clarification On Hybrid Capital Step-Ups, Call Options, And Replacement Provisions, Oct. 22, 2012
- General: Methodology: Hybrid Capital Issue Features: Update On Dividend Stoppers, Look-Backs, And Pushers, Feb. 10, 2010
- General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

Ratings Affirmed

TDC A/S

Corporate Credit Rating	BBB-/Stable/A-3
Senior Unsecured	BBB-
Junior Subordinated	BB

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com) and at [spcapitaliq.com](http://spcapitaliq.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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