FITCH AFFIRMS TDC AT 'BBB-'; OUTLOOK STABLE

Fitch Ratings-London-15 May 2017: Fitch Ratings has affirmed Denmark-based TDC A/S's Long-Term Issuer Default Rating (IDR) and senior unsecured rating at 'BBB-'. The Outlook is Stable. A full list of rating actions is at the end of this commentary.

TDC has improved leverage headroom within its rating over the past 12-24 months through a combination of dividend cuts, hybrid securities and asset sales. The company's strategy to reduce the decline in EBITDA is having some success and can be seen in 1Q17 results. However, visibility on the impact to cash flows from domestic competition and regulatory changes, although improving, remains weak. This has led to a more cautious set of forecasts in Fitch's base case scenario for the company. TDC is likely to sustain a free cash flow (FCF) margin of around 5% over the next two years, providing some financial flexibility to manage further operational pressure should it arise.

KEY RATING DRIVERS

Domestic Uncertainties Remain: Competition in the mobile and business segments of the Danish telecoms market is likely to remain high, driven by mobile operators such as Hutchison seeking build scale and public sector tenders that are highly price sensitive. Combined with industry sector uncertainties relating to the impact of European mobile roaming regulation, "cord cutting" and voice revenue declines the visibility on domestic EBITDA progression remains weak. This has led to a more cautious stance in Fitch's FCF forecasts for the company. The company has scope to weather further pressure if it materialised at its current 'BBB-' with FFO adjusted net leverage 3.7x.

Cautious Base Case View: Fitch's base case scenario for TDC envisages a stable FFO-adjusted net leverage profile over the next two years. This reflects potential declines in FFO offset by reduction in net debt as a result of retained FCF. We forecast a sustainable FCF margin of around 5% over the next two to three years. However, quicker-than-expected stabilisation in EBITDA is not unrealistic, and combined with lower ongoing restructuring costs could enable TDC to deleverage faster. Such a scenario would be an upside to Fitch's forecasts that would be positive for the rating.

Progress on Reducing Declines: TDC domestic EBITDA declined by an average of 12% a year between 2015 and 2016. At end-1Q17 the company was able to reduce the yoy decline to 3%, indicating that its strategy to reduce costs and focus on bundled product value and quality-based differentiation in conjunction with price increases is working. TDC aims to reduce operating costs by DKK600 million-700 million by 2018 through product rationalisation, simplification and restructuring. We believe most of these savings are yet to show through in TDC's financial metrics but they are likely be key to stabilising the company's EBITDA decline.

Fixed-Line Supportive: TDC owns both the incumbent copper network and most of the cable infrastructure in Denmark. This gives it a stronger domestic fixed-line position than its European peers. We view the position as structurally supportive for the company's long-term credit profile due to the lack of alternative fixed-line infrastructure. This enables TDC to sustain slightly higher leverage than peers and is reflected in the marginally higher (0.2x) FFO-adjusted net leverage levels the company can maintain for a given rating category. Current competitive pressures are more prevalent in the mobile and business segments.

Improved Leverage Headroom: TDC's FFO-adjusted net leverage reduced to 3.7x in 2016 from 4.6x at end-2014. The improvement was achieved despite a period of EBITDA decline in the domestic market and was largely due to a combination of asset disposals, cuts in dividends and the issuance of hybrid securities. At its current leverage level, the company's rating is comfortably positioned at 'BBB-'. TDC has the potential to deleverage further depending on EBITDA developments.

DERIVATION SUMMARY

TDC's rating reflects its leading position within the Danish telecoms market. The company has strong in-market scale and share that spans both fixed and mobile segments. The ownership of both cable and copper-based local access network infrastructure reduces the company's operating risk profile relative to its domestic European incumbent peers, which typically have infrastructure-based competition from alternative cable operators.

TDC is rated lower than its Dutch market-focused peer Royal KPN N.V (BBB/Stable) due to its higher leverage, lower financial flexibility and early stage of its current cost reduction strategy for 2015-2018. Higher-rated peers such as Orange S.A. (BBB+/Stable), Deutsche Telekom AG (BBB+/Stable) and Telefonica SA (BBB/Stable) have similar strong domestic profiles but also benefit from greater geographic diversification and lower leverage.

KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:
- revenue decline of 2.5% in 2017 and 2% in 2018;
- broadly stable EBITDA margin of 39%-40% in 2017-2019;
- implied capex to sales ratio of 22% in 2017 reducing to 21% by 2019 (including spectrum);
- dividends to grow by around 5% a year from 2018.

RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action
-The expectation that FFO-adjusted net leverage will fall below 3.7x on a sustained basis
-An improvement in TDC's domestic operating environment enabling a sustained stabilisation in domestic EBITDA
Future Developments That May, Individually or Collectively, Lead to Negative Rating Action
-FFO-adjusted net leverage above 4.2x on a sustained basis
-Further declines in the Danish business putting FCF margins under pressure into mid to low single digits.

LIQUIDITY

Strong Liquidity: TDC has sufficient liquidity, with undrawn revolving credit facilities of EUR500 million available until September 2021 and EUR200 million of bilateral credit facilities available until December 2018 along with available cash and cash equivalents of DKK1,687 million and forecast positive FCF across the rating horizon.

FULL LIST OF RATING ACTIONS

TDC A/S
--Long-Term IDR affirmed at 'BBB-'; Outlook Stable
--Senior unsecured notes affirmed at 'BBB-'
--Short-Term IDR affirmed at 'F3'
--Subordinated hybrid securities: affirmed at 'BB'

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Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable Criteria
Criteria for Rating Non-Financial Corporates (pub. 10 Mar 2017)
https://www.fitchratings.com/site/re/895493
Non-Financial Corporates Hybrids Treatment and Notching Criteria (pub. 27 Apr 2017)
https://www.fitchratings.com/site/re/896881