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Research Update:

DKT Holdings Affirmed At 'B+' As Norwegian Unit Sold; Outlook Stable; TDC Debt Off CreditWatch

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Table Of Contents

Overview

Rating Action

Rationale

Outlook

Ratings Score Snapshot

Issue Ratings--Recovery Analysis

Related Criteria

Related Research

Ratings List

Research Update:

DKT Holdings Affirmed At 'B+' As Norwegian Unit Sold; Outlook Stable; TDC Debt Off CreditWatch

(**Editor's Note:** We are republishing this article, originally published on Oct. 18, 2018, to update the estimates in our recovery analysis.)

Overview

- On Oct. 15, 2018, Danish telecom operator TDC sold its Norwegian business to Swedish telecom operator Telia.
- On Oct. 18, 2018, TDC announced that it would use about €2 billion of the proceeds to repay part of its €3.9 billion senior term loan, and we anticipate it will use the remainder on network investments in Denmark.
- We are affirming our 'B+' long-term issuer credit rating on TDC's parent, DKT Holdings, affirming our 'BB-' issue rating on TDC's €3.9 billion senior loan, and raising our issue rating on TDC's €1.0 billion senior unsecured notes and €500 million revolving credit facility to 'BB-'.
- We are removing the issue ratings from CreditWatch.
- The stable outlook reflects our expectation that a stabilization of EBITDA, alongside debt prepayments and increasing capital expenditures funded with the disposal proceeds, will result in pro forma adjusted debt to EBITDA of 7.0x-7.5x and about breakeven free operating cash flow over the next 12 months.

Rating Action

On Oct. 18, 2018, S&P Global Ratings affirmed its 'B+' long-term issuer credit ratings on DKT Holdings ApS, the ultimate parent of Danish telecommunications network operator TDC A/S, and on its subsidiary DKT Finance ApS. We also affirmed our 'B+/B' long- and short-term issuer credit ratings on TDC A/S. The outlook on all entities is stable.

We affirmed our 'BB-' issue rating on TDC's €3.9 billion senior secured term loan. The recovery rating on this instrument remains at '2', indicating our expectation of about 85% recovery for noteholders in the event of a payment default. This rating was removed from CreditWatch with negative implications, where we placed it on July 19, 2018.

We raised our issue rating on TDC's €1.0 billion senior unsecured notes and €500 million revolving credit facility (RCF) to 'BB-' from 'B+'. The recovery rating on these instruments is now '2', revised from '3' previously, indicating our expectation of about 85% recovery for noteholders in the event of a payment default. This rating was removed from CreditWatch with positive implications, where we placed it on July 19, 2018.

We affirmed our 'B-' issue rating on DKT Finance's €1.4 billion subordinated notes. The '6' recovery rating, indicating our expectation of zero recovery for noteholders in a payment default, remains unchanged.

Rationale

The affirmation reflects our understanding that TDC will use the majority of the proceeds from the sale of its Norwegian cable TV, broadband, and business-to-business operations to Swedish incumbent telecom operator Telia Company AB to repay debt. As such, in our view, this will offset the incrementally negative impact of the company's reduced footprint and smaller revenue base following the disposal. We forecast that, in 2018, TDC's entire Norwegian business, including the activities of cable operator Get A/S and TDC Norway's business-to-business activities, will generate about Danish krone (DKK) 3.0 billion of revenues and DKK1.3 billion of EBITDA before exceptional items, equivalent to 15% of group revenues and 16% of group EBITDA.

However, the affirmation also reflects that, although TDC will use the vast majority of proceeds for debt repayment, we nevertheless project the group's adjusted net debt to EBITDA will remain high, at more than 7.0x in pro forma 2018 and 2019 (about 4.5x-4.8x excluding shareholder loans). Reported free operating cash flow (FOCF) will be only about break-even over the same period. We understand that TDC will review its capital structure and related documentation and will make a final decision regarding the remaining proceeds (approximately DKK2 billion) in the coming quarters. However, our base-case assumption is that it will use the remaining sale proceeds to reinvest in its Danish business.

In our base case, we assume:

- Real GDP growth in Denmark of 1.9% in 2018 and 2019, paired with a relatively low unemployment rate of about 4%. We think these macroeconomic fundamentals support upselling of broadband and mobile to some extent, despite a limited link between business cycles and telecom spending.
- TDC's mobile subscriber market share remaining broadly stable as the company reaps the benefits of its positioning as a quality player, but continuing modest churn of broadband customers, mainly to resellers on TDC's infrastructure. We think TDC's market share in linear TV will remain stable, but expect further decline of this segment due to customer attrition to over-the-top (streaming media as a stand-alone product) services.
- Organic revenue decline in Denmark (excluding the divestment of TDC Hosting in April 2017) of 1.0%-2.0% in 2018 and 0.5%-1.5% in 2019, versus about 2.9% in 2017, mainly driven by lower revenue in the business to business segment, and some decline in business to companies (B2C) TV and landline.

- Our adjusted EBITDA margins of 42% in 2018, gradually improving to about 44% in 2019, after 42.6% in 2017, with restructuring costs affecting margins in 2018, while improvements are supported mainly by cost savings and improved profitability of the B2C mobile segment.
- Capex to sales, excluding spectrum, increasing to about 24%-25% in 2019-2020, against about 20% in first half of 2018, as we expect the company to step up its investments in its fixed broadband expansion.
- Modest spectrum payments of up to DKK400 million (about €54 million) in 2018, including for the upcoming auction, and DKK200 million-DKK300 million in 2019.
- Cash outflow of about DKK 200 million relating to settlement of the Performance Share Program for TDC's previous management.
- A final hybrid coupon payment of DKK195 million in 2018, and moderate shareholder distributions in 2019.

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

- Debt to EBITDA of 7.1x-7.3x in 2018 and 7.0x-7.4x in 2019-2020 (4.5x–4.8x in 2018 and 2019 excluding shareholder loans), compared with 3.2x for TDC in 2017.
- Funds from operations (FFO) to debt of 9.0%-11.0% in 2018 and 6.0%-8.0% in 2019, after 25.4% in 2017.
- FOCF to debt of 1.0%-2.0% in 2018 and 0.0%-1.0% in 2019-2020, compared with 10.7% in 2017.

Liquidity

We assess DKT Holdings' liquidity as adequate, since we expect the ratio of liquidity sources to liquidity uses will comfortably exceed 1.2x in the 12 months from Oct. 15, 2018. We think that DKT Holdings' risk management aims to maintain adequate, though not necessarily strong, liquidity.

As of Oct. 15, 2018, we estimate that principal liquidity sources over the ensuing 12 months include:

- Estimated cash balances of about DKK1.8 billion.
- Committed RCFs totaling €600 million (about DKK4.5 billion), of which €500 million at TDC and €100 million at DKT Finance.
- FFO of DKK4.7 billion–DKK4.9 billion.
- Cash inflow of about DKK16.6 billion from the sale of its Norwegian business

For the same period, we estimate that principal liquidity uses include:

- DKK15 billion prepayment of senior secured term loans.
- Annual capex of about DKK4.5 billion.
- Moderate regular shareholder distributions in 2019.

The RCFs issued by TDC and DKT Finance stipulate springing maintenance covenants relating to net debt to EBITDA, as defined in the covenants. We forecast comfortable headroom of more than 30% under these covenants in the next 24 months.

Outlook

The stable outlook on DKT Holdings reflects our view that the group's operating performance in Denmark will continue to improve, particularly in 2019, driven by better pricing in consumer mobile and further cost savings, contributing to gradually easing revenue decline and stable or modestly growing EBITDA. We think this will enable DKT Holdings to maintain adjusted debt to EBITDA, including shareholder loans, of 7.0x–7.5x and FOCF to debt of 0%-2% in 2018-2019.

Downside scenario

We could lower the rating if intense competition, a surge in capex, or shareholder distributions caused adjusted debt to EBITDA to increase above 8.5x, and FOCF was negative for a prolonged period.

Upside scenario

We could raise the rating if higher-than-expected EBITDA and FOCF growth supported a sustained improvement in our adjusted debt to EBITDA to below 5.5x and FOCF to debt of more than 5%.

Ratings Score Snapshot

Issuer Credit Rating: B+/Stable/--

Business risk: Satisfactory
- Country risk: Very low
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Highly Leveraged
- Cash flow/Leverage: Highly Leveraged

Anchor: b+

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 rating analysis: Neutral (no impact)

Issue Ratings--Recovery Analysis

Key analytical factors

- The issue rating on the senior secured term loan is rated 'BB-', and with a '2' recovery rating.
- The issue rating on the €1.0 billion unsecured notes and the €500 million RCF at TDC is now 'BB-', up from 'B+' previously. The recovery rating is now '2', revised from '3' previously.
- These ratings are now off CreditWatch, the term loan off CreditWatch with negative implications, and the unsecured notes from CreditWatch with positive implications, where we placed them on July 19, 2018.
- We expect that DKT will use €2 billion of the proceeds from its sale of Get to prepay the €3.9 billion term loan.
- We raised our ratings on the unsecured notes because the notes now rank equal to the term loans. The senior secured nature of the term loan and the pledge of shares in TDC offer creditors almost no advantage over unsecured noteholders with respect to their ability to extract value from operating assets at TDC. This is because the senior secured term loan and the unsecured notes will not be part of the same intercreditor agreement.
- Therefore, we assume that term loan lenders will not be able to enforce a priority claim over unsecured creditors in a default scenario. At the same time, we estimate that the residual value for equity holders at TDC will be zero and the share pledges over TDC will not produce additional recovery value.
- The term loan's security package consists of pledges over shares held in TDC by its direct parent, DK Telekommunikation ApS, share pledges over TDC's Norwegian subsidiary Get, and bank accounts and intragroup receivables of all three entities. However, as the Get asset has been sold, it no longer gives any recovery priority to the term loan lenders.
- We expect substantial recovery prospects of about 85% for the senior debt (notes and term loans), reflecting its structural seniority to debt issued at DKT Finance.
- The subordinated notes issued by DKT Finance are rated 'B-', with a '6' recovery rating. We expect recovery prospects to be negligible (at 0%), reflecting the notes' structural subordination to debt issued at TDC and to the €100 million super senior RCF at DKT Finance.
- We view the documentation of the proposed €3.9 billion term loan as issuer friendly. The only maintenance covenant is a 7.3x springing net

leverage covenant on the €500 million RCFs, which applies if the RCF included in these facilities is at least 40% drawn. Debt incurrence is subject to a general basket of €675 million over the life of the facility, and is permitted with unlimited amounts if net leverage in TDC's consolidation perimeter is below 4.25x. Distributions are subject to a 4.25x net leverage test and a general basket totaling €565 million over the life of the facilities.

- In our simulated default scenario, we assume that tough competition from other telecom operators in the broadband and mobile segments, paired with loss of TV customers to over-the-top services, would result in substantial pressure on EBITDA. Together with continued high capex, this would lead to a hypothetical payment default in 2022.
- We value DKT Holdings Aps, the ultimate parent of the group, as a going concern because it is the incumbent network operator in Denmark, with ownership of the leading mobile, fixed-line broadband, and cable-TV networks, and has an established position across all sub segments of the telecom services market.

Simulated default assumptions

- Year of default: 2022
- Minimum capex (share of sales): 6% (9%-10% including the operational adjustment, based on our view of minimum capex requirements for cable and telecom operators)
- No cyclicality adjustment, in line with our standard assumption for the telecom and cable industry
- Operational adjustment: +15% (to reflect minimum capex higher than 6% of sales)
- EBITDA at emergence: about DKK4.48 billion
- Enterprise value (EV) multiple: 6.0x
- Jurisdiction: Denmark

Simplified waterfall

- Gross EV at default: about DKK23.3 billion
- Net EV after administrative costs (5%): DKK22.1 billion
- Priority claims: zero
- Estimated senior debt claims at TDC: DKK25.4 billion [1][2]
- Value available for secured claims: DKK22.1 billion
- --Recovery prospects: 70%-90% (rounded estimate 85%)
- Recovery rating: 2
- Estimated senior debt claims at DKT Finance ApS: DKK10.8 billion
- Value available for senior claims: Nil.

- --Recovery prospects: 0%-10% (rounded estimate 0%)
- Recovery rating: 6

[1] All debt amounts include six months of prepetition interest. [2] Revolving facilities assumed to be 85% drawn at default.

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Corporates - General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria - Corporates - Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Telecommunications And Cable Industry, June 22, 2014
- Criteria - Corporates - General: The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate Entities, April 29, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- DKT Holdings Affirmed At 'B+' On Sale Of Norwegian Unit; Outlook Stable; TDC Debt On CreditWatch, July 19, 2018

Ratings List

Ratings Affirmed

DKT Holdings ApS

Issuer Credit Rating	B+/Stable/--	B+/Stable/--
DKT Finance ApS		
Issuer Credit Rating	B+/Stable/--	B+/Stable/--
Subordinated	B-	B-
Recovery Rating	6(0%)	6(0%)

Ratings Affirmed; Upgraded; Recovery Ratings Revised; Recovery Expectations Revised

TDC A/S		
Issuer Credit Rating	B+/Stable/B	B+/Stable/B
Senior Secured	BB-	BB-/Watch Neg
Recovery Rating	2(85%)	2(70%)
Senior Unsecured	BB-	B+/Watch Pos
Recovery Rating	2(85%)	3(55%)

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