Research Update:

DKT Holdings Downgraded To 'B'; Outlook Stable

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Rating Action Overview

- DKT Holdings ApS, parent of Danish telecom operator TDC A/S, has indicated heavier investments in 2020 than we forecast, reflecting aggressive fiber layout and conversion of its entire mobile network to fifth-generation ready technology.
- Therefore, we have revised our forecast of S&P Global Ratings-adjusted debt to EBITDA to 6.7x (excluding shareholder loans) in 2020, compared with our previous expectation of less than 6.0x.
- We are therefore lowering our ratings on DKT Holdings to 'B' from 'B+'.
- The stable outlook reflects our expectation of stable EBITDA in 2020, due in particular to lower nonrecurring costs and content cost savings, and that management would consider cutting discretionary outlays if needed to keep leverage in check.

Rating Action Rationale

We believe TDC will substantially increase investments in fifth-generation (5G) and fiber layout acceleration in 2020. In our view, Danish telecommunications network operator TDC's capital expenditure (capex; excluding spectrum payments) will shoot up to about Danish krone (DKK) 5.9 billion for full-year 2020, representing 35% of sales, as the company accelerates its fiber network layout and builds its 5G network to confront fierce domestic competition and alternative infrastructure operators. However, capex is likely to substantially deflate in 2021.

TDC's aggressive financial policy will spike in 2020, but it should, however, recede slightly from 2021. The combination of considerably higher debt-funded network investments and a likely outlay for 5G spectrum leads us to forecast S&P Global Ratings-adjusted leverage of 6.7x in 2020 (9.6x including shareholder loans), up from about 6.2x in our 2019 estimates, compared with our previous expectation of less than 6.0x in 2020 and gradually trending down toward 5.5x thereafter.

Due to these heavy investments, we expect TDC's free operating cash flow (FOCF) will further deteriorate from an already negative level in 2019 following the 4G spectrum investment. FOCF should improve substantially in 2021, however, based on our assumption of EBITDA turnaround and considerably lower investments after the temporary spike in 2020. It may remain negative after lease payments in 2021, but we think management has the flexibility to cut outlays after

2020, depending on its EBITDA trajectory, which will support its objective of reducing leverage after2020.

We expect TDC will post about-flat S&P Global Ratings-adjusted EBITDA in 2020 due to lower costs and a relatively sound subscriber trend. We expect lower content-related costs in 2020 due to the end of the Discovery contract, as well as reduced expenditure on the pending network separation process. This, combined with other savings and potential commercial traction, or at least better client retention in TV from sports and own content investments, should substantially reduce the drag on EBITDA. In addition, fiber take up should help improve the customer mix and raise prices, while we foresee steady performance in the consumer fixed broadband and mobile segments.

TDC's position as the leading telecom operator in Denmark, its well-invested mobile and cable network, and its sound, yet temporarily weakened EBITDA margins, support our view of DKT Holdings' business risk profile. Thanks to recent investments, TDC's 4G coverage wasextended to more than 99.5% of the Danish population at the end of 2019. Furthermore, 100% of its own cable network was recently upgraded to 1GB broadband speeds. The on-going fiber rollout and the 5G mobile swap should further support the group's position in the longer term.

TDC's exposure to the tough market conditions in the fragmented Danish market represents a key weakness. The company continues to face fierce competition in the Danish telecoms market. TDC competes with three other mobile network operator's in the same Danish market, as well as utility companies that are deploying and commercializing fiber.

Outlook

The stable outlook reflects our expectation that the company's EBIDTA will stabilize in 2020 thanks to lower operating and exceptional costs, resilient mobile and fixed broadband revenue, and some traction from its extended fiber footprint and content investments. It also reflects our forecast of S&P Global Ratings-adjusted senior debt leverage for DTK Holdings of less than 7x in 2020, receding slightly thereafter, and considerably improving FOCF in 2021 on the back of lower investments and increasing EBITDA.

Downside scenario

The ongoing initiatives carry meaningful execution risk, given the combination of heavy network and content investments, the separation process, and a fiercely competitive market.

We could downgrade DKT Holdings if:

- EBITDA fails to stabilize in 2020;
- S&P Global Ratings-adjusted debt to EBITDA increases to more than 7x (or more than 10x including shareholder loans) in 2020;
- EBITDA cash interest cover weakens to less than 3x; or
- FOCF fails to dramatically recover in 2021.

Upside scenario

We view rating upside as remote given the company's more aggressive financial policy than previously anticipated. It would require, in particular, adjusted senior debt leverage at or below 5.5x (8.5x including shareholder loans).

Company Description

TDC is the incumbent operator and a provider of integrated communications and entertainment solutions in Denmark, with a leading market position across fixed broadband (51% market share), pay TV (55% market share), mobile (44% market share), and landline voice services (65% market share), based on end-user subscriptions to consumer, business, and wholesale customers. At the end offourth-quarter 2019, TDC had approximately 6 million revenue-generating units (RGUs), about 1.23 million broadband subscribers, and 0.48 million fixed-line telephony subscribers, as well as 1.17 million TV customers.

Our Base-Case Scenario

In our base case, we assume:

- Real GDP growth in Denmark of 1.1% in 2019 and 1.5% in 2020, following 0.7% in 2018, coupled with a relatively low unemployment rate of about 5%. We think these macroeconomic fundamentals support broadband and mobile upselling to some extent, despite a limited link between business cycles and telecom spending.
- After an organic revenue decline of about 2.3% in 2019, we expect revenue will gradually stabilize in 2020. This will mainly result from average revenue per user (ARPU) increases, stemming from steady mid-single-digit growth in consumer mobile and fixed broadband, about flat growth in TV due to traction from the monetization of network and content investments, and balanced in part by lower revenue in the business-to-business segment and landline.
- We expect adjusted EBITDA margin after restructuring (including International Financial Reporting Standards [IFRS] 16 impact) will remain flat at about 37% in 2020, from 37% in 2019. This is primarily a result of decreasing content costs. Thereafter, we expect a gradual margin improvement, with adjusted EBITDA margin reaching just over 38% by 2021.
- Capex to sales (excluding license payment) peaking at about 35% in 2020, from about 28% in 2019 (and 24% in 2018) and by our estimate falling to below 25% of sales in 2021.
- Our assumption of about DKK500 million spent on 5G spectrum in 2020.

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

- Adjusted debt to EBITDA of 9.5x to 9.7x in 2020-2021, including shareholder loans.
- Adjusted debt to EBITDA excluding shareholder loans of 6.7x in 2020, down to 6.6x in 2021.
- Heavily negative reported FOCF due to capital investment in 2020, but breaking even before lease payments in 2021.
- Negative discretionary cash flows in 2020-2021, assuming steady dividend payments.

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 Jan. 1, 2020. We think that DKT Holdings' risk management aims to maintain adequate, though not necessarily strong liquidity.

As of Jan. 1, 2020, we estimate that principal liquidity sources over the ensuing 12 months include:

- Estimated cash balances of about DKK1.5 billion;
- Committed revolving credit facilities (RCFs) totaling €600 million (about DKK4.5 billion), of which €500 million at TDC and €100 million at DKT Finance. Unused portion as of December 31, 2019 is about €500 million; and
- FFO of DKK4.5 billion–DKK4.7 billion.

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

- Annual capex of about DKK6.4 billion;
- Moderate regular shareholder distributions in 2020; and
- Seasonal negative working capital of DKK250 million-DKK350 million annually.

Covenants

The RCFs issued by TDC and DKT Finance ApS stipulate springing maintenance covenants subject to net debt to EBITDA remaining below 7.3x, as defined in the covenants (net debt excludes shareholder loans and debt at DKT Finance). We forecast comfortable headroom of more than 30% under these covenants in the next 24 months.

Issue Ratings - Recovery Analysis

Key analytical factors

- The issue rating on the senior secured term loan, the €1.0 billion unsecured notes, and the €500 million RCF at TDC is 'B+', with a '2' recovery rating.
- 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 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 subordinated notes issued by DKT Finance are rated 'CCC+', 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.

- 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 2023.
- We value DKT Holdings, 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 subsegments of the telecom services market.

Simulated default assumptions

- Year of default: 2023
- 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 DKK3.94 billion
- Enterprise value (EV) multiple: 6.0x
- Jurisdiction: Denmark

Simplified waterfall

- Gross EV at default: about DKK23.6 billion
- Net EV after administrative costs (5%): DKK22.4 billion
- Priority claims: zero
- Estimated senior debt claims at TDC: DKK25.59 billion [1][2]
- Value available for secured claims: DKK22.4 billion
- --Recovery prospects: 70%-90% (rounded estimate 85%)
- Recovery rating: 2
- Estimated senior debt claims at DKT Finance: DKK10.9 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.

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: Negative (-1 notch)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate

Entities, Nov. 13, 2012

- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Downgraded; Outlook Action

	To	From
DKT Holdings ApS		
Issuer Credit Rating	B/Stable/--	B+/Negative/--
TDC A/S		
Issuer Credit Rating	B/Stable/B	B+/Negative/B
Senior Secured	B+	BB-
Recovery Rating	2(85%)	
Senior Unsecured	B+	BB-
Recovery Rating	2(85%)	
DKT Finance ApS		
Issuer Credit Rating	B/Stable/--	B+/Negative/--
Subordinated	CCC+	B-
Recovery Rating	6(0%)	

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 for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings 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.