FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms DKT's IDR at 'B+'; Outlook Stable

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Fitch Ratings - Frankfurt am Main - 03 Mar 2021: Fitch Ratings has affirmed DKT Holdings ApS's (DKT), the owner of Danish telecoms company TDC A/S (TDC), Long-Term Issuer Default Rating (IDR) at 'B+' with a Stable Outlook.

The ratings of DKT reflect high leverage and intense competition, which is likely to persist in all business segments. However, we expect that TDC to be able to address pressures on revenues with efficient cost-optimisation measures. The ratings are supported by its strong domestic positions in mobile, broadband and TV businesses underpinned by its leadership in infrastructure quality and coverage.

The affirmation reflects our expectation of funds from operations (FFO) net leverage remaining comfortably within the rating's thresholds. We believe that the company retains good flexibility in managing its leverage via capex and dividends.

Fitch also upgraded the rating of senior unsecured notes to 'BB+'/'RR1' from 'BB'/'RR2' following our revised view of the structural and legal characteristics of the debt.

Feedback

KEY RATING DRIVERS

High Leverage Sustainable: We expect DKT's FFO net leverage to remain stable at around 6.1x in 2021-2023, implying healthy headroom under our rating sensitivities. Leverage in

2019-2021 is under pressure from large investments in fixed and mobile infrastructure, which we expect to notably reduce from 2022. We expect that with the decline in capex, DKT is likely to resume dividend payments, constraining its deleveraging. However, DKT has a record of prudent approach and we believe it retains flexibility in managing its leverage via dividend cuts and phasing its capex programme.

Capex to Moderate: We expect capex to peak in 2021 and to decline to 20%-25% of sales in 2022-2024 from around 30%-35% in 2019-2021. The peak capex is driven by heavy investments in 5G and fibre network deployment, which we believe would be supportive of maintaining TDC's long-term competitiveness. With its 5G network upgrade largely completed, the fibre rollout will be the main component of its expansionary capex programme. TDC retains substantial flexibility in managing the pace of this rollout. Active partnerships with utility companies secure fibre coverage in areas where TDC does not have its own fibre network.

Intense Competition: The Danish telecoms market is highly competitive, which results in ongoing pressures on TDC's sales. It saw a double-digit yoy decline in its TV segment's revenue in 2020 after a dispute with Discovery was followed by a removal of its channels from TDC's TV offerings. This had a negative impact on its mobile and internet segments where contracts were tied to TV and customers are sensitive to content proposition. The pressure was most pronounced in 1H20, before easing in 2H20 as revenue improved. We expect the segment to stabilise from 2021, supported by investments in additional content.

5G Capex to Show Results: Accelerated investments in 5G and an early launch of the service nationwide ahead of other operators should give TDC some competitive advantage in mobile, which we expect to start feeding into improved performance in 2021. Visibility on the fibre-rollout impact is limited in the medium term as it depends on the level of competitive intensity and fibre take-up rates. However, we believe strong fibre coverage provides long-term protection in the form of wholesale revenue from third-party operators.

Feedback

Margins Improvement: Strong implementation of cost-efficiency measures suggests potential further improvement in profitability. TDC reported a 9.5% yoy decline in operating expenses in 2020, which resulted in a 1.5pp yoy increase in Fitch-defined EBITDA margin for that period. The completion of separation of network and service companies and of 5G rollout should support margins in 2021 on top of ongoing cost-optimisation initiatives. However, we expect some increase in content acquisition to reverse declining revenue in TV to limit margin expansion. Overall we expect profitability improvement to offset expected declining revenue in 2021-2022 to result in largely stable EBITDA.

Senior Unsecured Debt Upgrade: We upgraded the rating of senior unsecured notes at TDC A/S following our revised view that the structural and legal characteristics of the debt are sufficiently robust not to apply a cap at 'RR2' and to treat TDC's senior secured and senior unsecured debt on a pari passu basis. TDC's operating subsidiaries Nuuday and TDC NET, due to their demerger under Danish law, will be liable on a statutory basis to satisfy existing noteholders' claims if TDC defaults on these notes. Our recovery waterfall suggests 97% recovery for both secured and unsecured instruments. Under Fitch's criteria, senior unsecured debt is typically capped at 'RR2'.

DERIVATION SUMMARY

DKT's ratings reflect TDC's leading position within the Danish telecoms market. The company has strong in-market scale and market shares in both the fixed and mobile segments. Ownership of both the cable and copper-based local access network infrastructure partly reduces the company's operating risk profile, even though TDC faces network competition from FTTH fibre deployed by Danish electricity companies in parts of the country. Domestic European incumbent peers typically face infrastructure-based competition from cable network operators.

DKT is rated lower than other peer incumbents, such as Royal KPN N.V (BBB/Stable), due to notably higher leverage. It is more in line with cable operators with similarly high leverage, such as VodafoneZiggo Group B.V. (B+/Stable), Telenet Group Holding N.V. (BB-/Stable) and Virgin Media Inc. (BB-/Stable). DKT's incumbent status, leading positions in both the fixed and mobile markets, and unique infrastructure ownership justify higher leverage thresholds than cable peers.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Low single-digit revenue decline in 2021-2022 and growth of less than 1% in 2023-2024

- Fitch-defined EBITDA margin to improve to 37.4% in 2023 from 36.5% in 2021, on the back of an extensive cost-transformation plan

- Capex to peak at 35% of revenue in 2021, which includes deferred cash capex payment from 2020, before falling to around 22%-23% in 2022-2024

- No dividend in 2021 and dividends of around DKK400 million per year in 2022-2023

- Negative working capital change of around 1%-1.5% of revenue in 2022-2024

KEY RECOVERY RATING ASSUMPTIONS

-The recovery analysis assumes that the company would be considered a going concern in bankruptcy and that it would be reorganised rather than liquidated

- A 10% administrative claim

-Our going-concern EBITDA estimate of DKK5 billion reflects Fitch's view of a sustainable, post-reorganisation EBITDA level upon which we base the valuation of the company

-Our going-concern EBITDA estimate is 14% below the Fitch-defined 2020 EBITDA

- An enterprise value (EV) multiple of 6x is used to calculate a post-reorganisation valuation and reflects a distressed multiple. The multiple reflects TDC's incumbent position in Denmark and is also in line with that used for large European cable operators, which also have solid market position and own significant network assets

- We estimate the total amount of debt claims at DKK39.1 billion, which includes debt instruments at the opco and holdco levels, as well as full drawings on available credit facilities, comprising EUR845 million facilities at TDC and a EUR100 million revolving credit facility (RCF) at DKT Finance ApS.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- FFO net leverage sustainably below 5.7x

- Neutral-to-positive free cash flow (FCF) reflecting a stable competitive market position and a normalising capex profile

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- FFO net leverage sustainably above 6.5x

- Increased competitive intensity in the Danish telecoms market, resulting in declining EBITDA margin and weak pre-dividend FCF.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Reasonable Liquidity: At end-2020, DKT had a consolidated cash balance of DKK459 million. We expect the business to generate negative pre-dividend FCF until 2022 due to high capex.

It has sufficient liquidity provided by EUR845 million RCF at TDC and a EUR100 million RCF at DKT Finance ApS. Both facilities were undrawn as of end-2020. The latter at DKT Finance ApS will see EUR50 million expire in 2021 and the remainder in 2022. The RCF at TDC expires in 2024. The debt maturity profile is reasonable, with the next debt repayment in 2022.

Feedback

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY/DEBT	RATING			RECOVERY	PRIOR
TDC A/S					
• senior secured	LT	BB+	Affirmed	RR1	BB+
• senior unsecured	LT	BB+	Upgrade	RR1	BB
DKT Holdings ApS	LT IDR	B+ Rating Outlook Stable	Affirmed		B+ Rating Outlook Stable
DKT Finance ApS					
• senior secured	LT	B-	Affirmed	RR6	B-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019) (including rating assumption sensitivity)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 21 Dec 2020)

Corporate Rating Criteria (pub. 21 Dec 2020) (including rating assumption sensitivity)

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APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

DKT Finance ApS	EU Issued, UK Endorsed
DKT Holdings ApS	EU Issued, UK Endorsed
TDC A/S	EU Issued, UK Endorsed

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