

Research Update:

Danish Telecom Network Operator DKT Holdings ApS (TDC) Affirmed At 'B' On Delayed Peak In Leverage; Outlook Stable

March 5, 2021

Rating Action Overview

- We expect that the decline in Danish telecommunications network operator TDC A/S's revenues will gradually slow down and flatten by year-end 2022, as large investments translate into growth opportunities in mobile and fiber. We therefore forecast stable S&P Global Ratings-adjusted EBITDA in 2021 and 2022.
- We expect that TDC will have higher capital expenditure (capex) and larger working capital outflows in 2021, following capex delays and favorable working capital movements in 2020. As a result, we expect significantly negative free operating cash flow in 2021 instead of 2020.
- At the same time, TDC's leverage was stronger than we expected in 2020, at 5.9x. It should peak at about 6.5x-6.6x in 2021 and 2022, or 9.8x-10.2x including shareholder loans, but remain commensurate with the rating.
- We are therefore affirming our 'B' long-term issuer credit rating on TDC's parent, DKT Holdings ApS. We are also affirming our 'B+' issue rating on the notes and term loans issued by TDC and our 'CCC+' issue rating on the subordinated notes issued by DKT Finance ApS.
- The stable outlook reflects our expectation of a slowdown in the revenue decline, stable EBITDA, and negative free operating cash flow due to continued high infrastructure investments in 2021, with leverage remaining below 7.0x, or 10.0x-10.5x including shareholder loans.

PRIMARY CREDIT ANALYST

Sandra Wessman
Stockholm
+ 46 84 40 5910
sandra.wessman@spglobal.com

SECONDARY CONTACTS

Thierry Guermann
Stockholm
+ 46 84 40 5905
thierry.guermann@spglobal.com

Natalia Arrizabalaga
Paris
+ 33 1 4420 6662
Natalia.Arrizabalaga@spglobal.com

Rating Action Rationale

We expect continued pressure on TDC's topline, balanced by a gradual rebound in the next 18 months and lower operating expenditures. In 2020, TDC posted a revenue decline of about 5.6%, primarily relating to subscriber losses in landline voice, TV, and digital subscriber line (DSL), with the revenue decline in landline voice and TV particularly acute at 13.1% and 12.3%, respectively. We expect that 2021 and 2022 will remain challenging because the likely revenue growth from

network investments--which should ultimately result in higher average revenue per user (ARPU) in mobile and upgrades of fixed broadband customers to fiber--is unlikely to outpace the revenue decline in legacy products. However, we anticipate a slowdown of the revenue decline in the next 18 months, leading to flat sales growth by the end of 2022 and slight growth in 2023. TDC's inability to stabilize its revenue decline, despite the significant network investments, could weaken our assessment of its business. In the near term, we expect that the revenue decline will, to a large extent, be balanced by cuts in operating expenditure, particularly nonrecurring items, once the separation of two business units, NetCo and OpCo, is completed. This will lead to broadly flat S&P Global Ratings-adjusted EBITDA in 2021-2022 compared to 2020, of about Danish krone (DKK) 6.2 billion.

We expect continued high capex, negative working capital, and a high interest burden to result in significantly negative free operating cash flow (FOCF) in 2021. We have revised downward our estimate of FOCF before lease payments to negative DKK1.7 billion-DKK1.8 billion in 2021 and to between breakeven and negative DKK0.5 billion in 2022. This is due to our expectation of higher capex, including spectrum payments, of about DKK5.4 billion in 2021, representing about 34% of sales, compared with about DKK4.1 billion in our previous forecast. The revision of our forecast relates to TDC spreading the payments for certain capex projects executed in the last quarter of 2020 over 2021. We expect that capex will continue on the 5G and fiber networks to mitigate fierce domestic competition from alternative infrastructure operators. We expect that capex will peak in 2021 at 33%-35% of sales, but that it will then decline, albeit to a high level of 25%-30% of sales in 2022. In addition, we expect that working capital changes will weigh on TDC's cash flows in 2021, primarily due to the temporary liquidity support package from the Danish state relating to the COVID-19 pandemic in 2020. This includes the postponement of VAT and employee tax payments, which we expect will result in a cash outflow of approximately DKK350 million in 2021.

We expect leverage to increase in 2021, but remain within the rating thresholds. The combination of negative FOCF and the absence of EBITDA growth results in our expectation of an increase in leverage to about 6.5x in 2021 from 5.9x in 2020 (to about 9.8x from 9.0x including shareholder loans), before stabilizing at about 6.5x-6.6x in 2022. This is close to the maximum threshold for the rating of nearly 7.0x. However, we expect that management would take measures, if needed, to prevent leverage rising higher, for instance by cutting discretionary spending. We take a positive view of the fact that TDC suspended dividends in 2020.

TDC continues to have a strong market position despite tough competition. We regard the Danish telecom market as highly competitive across all segments, with four players in the mobile market and utility companies competing in the fixed market. Despite these competitive pressures, TDC has leading market shares in fixed broadband (45%), pay-TV (51%), mobile (38%), and landline voice services (65%), based on end-user subscriptions of consumer, business, and wholesale customers. We expect continued pressure on market share in the TV and broadband segments before fiber investments reach a certain level in 2021 and 2022. However, investments and new brand launches in the mobile market led to market share gains in the last quarter of 2020, and we expect TDC's market shares to remain at least stable in the next couple of years.

Outlook

The stable outlook reflects our expectation that the decline in TDC's topline will slow down and gradually become flat in the next 18 months, and, coupled with lower operating and exceptional

costs, lead to broadly stable EBITDA in 2021-2022. The outlook also reflects our forecast of adjusted leverage below 7.0x, despite significantly negative FOCF in 2021 due to extensive capex.

Downside scenario

The ongoing business initiatives carry meaningful execution risk, due to the combination of heavy investments in network and content, the separation of NetCo and OpCo, and a fiercely competitive market. We could downgrade DKT Holdings if:

- The revenue decline does not slow down and become flat by the end of 2022, for instance because of a market-share loss;
- Adjusted debt to EBITDA increases toward 7.0x (10.0x-10.5x including shareholder loans);
- Adjusted EBITDA cash interest coverage weakens to less than 3x; or
- There is no evidence of a transition to positive FOCF generation by 2022.

Upside scenario

We view rating upside as remote due to TDC's aggressive financial policy. Rating upside would require adjusted senior debt leverage of or below 5.5x (8.0x-8.5x including shareholder loans) and positive FOCF generation on a sustainable basis.

Company Description

TDC is the incumbent operator and a provider of integrated communications and entertainment solutions in Denmark, with annual revenue of DKK16.1 billion (about €2.2 billion) in 2020. At the end of fourth-quarter 2020, TDC had approximately 5.8 million revenue-generating units, about 3.1 million mobile subscribers, 1.14 million broadband subscribers, and 0.48 million fixed-line telephony subscribers, as well as 1.03 million TV customers.

Our Base-Case Scenario

Assumptions

- Annual real GDP growth in Denmark of 3.3%-3.5% in 2021-2022, following a decline of 4.0% in 2020.
- A low-single-digit revenue decline in 2021-2022 stemming from continued competitive pressure in TV, DSL, and landline voice, before reverting to growth in 2023, supported by higher ARPU in mobile and upgrades to fiber.
- An adjusted EBITDA margin after restructuring of around 39%-40% in 2021-2022, slightly above 38.9% in 2020, stemming from continued cost control and gradually declining nonrecurring costs from redundancy programs.
- Cash outflows from capex, including spectrum payments, of about DKK5.4 billion in 2021, falling to about DKK4.2 billion in 2022.
- A working capital outflow of DKK350 million in 2021, relating to postponed taxes from 2020.

- No acquisitions or shareholder distributions in 2021-2022.

Key metrics

DKT Holdings ApS Key Metrics*

| (Mil. €) | --Fiscal year ended Dec. 31-- | | | |
|---|-------------------------------|-------|-----------------|-------------|
| | 2019a | 2020e | 2021f | 2022f |
| Revenue growth (%) | 47.2 | (5.6) | (1.0)-(3.0) | (1.0)-(3.0) |
| EBITDA (DKK million) | 6,360 | 6,262 | 6,100-6,300 | 6,100-6,300 |
| EBITDA margin (%) | 37.3 | 38.9 | 39-41 | 39-41 |
| Capital expenditure | 5,021 | 4,735 | 5,200-5,600 | 4,000-4,400 |
| Free operating cash flow (DKK million) | (564) | (150) | (1,600)-(2,000) | (100)-(400) |
| Debt to EBITDA, excluding shareholder loans (x) | 6.0 | 5.9 | 6.3-6.7 | 6.3-6.7 |
| Debt to EBITDA (x) | 8.8 | 9.0 | 9.5-10.5 | 9.5-10.5 |

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

Liquidity

We assess DKT Holdings' liquidity as adequate, since we expect the ratio of liquidity sources to liquidity uses to comfortably exceed 1.2x in the 12 months from Jan. 1, 2021. We think that DKT Holdings' risk management aims to maintain adequate, though not necessarily strong, liquidity. We also regard liquidity as adequate when including the €500 million debt maturity in March 2022.

As of Jan. 1, 2021, we estimate that principal liquidity sources over the subsequent 12 months include:

- An estimated cash balance of about DKK0.46 billion;
- Committed revolving credit facilities (RCFs) totaling €600 million (about DKK4.5 billion), of which €500 million are at TDC and €100 million at DKT Finance ApS;
- A newly contracted RCF of €345 million (about DKK 2.6 billion); and
- Funds from operations of DKK3.5 billion–DKK3.8 billion.

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

- Annual cash capex of about DKK5.4 billion; and
- Negative working capital of DKK350 million.

Covenants

The RCFs issued by TDC and DKT Finance have springing maintenance covenants stipulating net debt to EBITDA below 7.3x, with net debt excluding 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 (the term loan and notes), 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 the unsecured noteholders with respect to their ability to extract value from the operating assets at TDC. This is because the senior secured term loan and the unsecured notes are not part of the same intercreditor agreement. In addition, the Danish Companies Act offers the unsecured noteholders protection through provisions relating to statutory demerger liabilities. Therefore, we assume that the term loan lenders will not be able to enforce a priority claim over the unsecured creditors in a default scenario. At the same time, we estimate that the residual value for the equity holders at TDC will be zero, and that the share pledges over TDC will not produce additional recovery value.
- The subordinated notes issued by DKT Finance have an issue rating of 'CCC+', with a '6' recovery rating. We expect recovery to be negligible, at 0%, reflecting the notes' structural subordination to the 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 network operators in the broadband and mobile segments, paired with a 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 2024.
- 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: 2024
- Minimum capex (share of sales): 6% (9%-10% including the operational adjustment), based on our view of the minimum capex requirements for cable and telecom network operators
- No cyclicity 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 DKK4.3 billion
- Enterprise value (EV) multiple: 6.0x
- Jurisdiction: Denmark

Simplified waterfall

- Gross EV at default: About DKK25.96 billion
- Net EV after administrative costs (5%): DKK24.66 billion
- Priority claims: Zero
- Estimated senior debt claims at TDC: DKK27.9 billion [1] [2]
- --Recovery prospects: 70%-90% (rounded estimate: 85%)
- Recovery rating: 2
- Estimated senior debt claims at DKT Finance: DKK11.1 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] We assume 85% of the RCFs to be 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
- Capital structure: Neutral
- Liquidity: Adequate
- Financial policy: Neutral
- Management and governance: Satisfactory
- 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 23, 2014
- Criteria | Corporates | General: The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate Entities, April 29, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed

DKT Holdings ApS

DKT Finance ApS

Issuer Credit Rating B/Stable/--

TDC A/S

Issuer Credit Rating B/Stable/B

DKT Finance ApS

Subordinated CCC+

Recovery Rating 6(0%)

TDC A/S

Senior Secured B+

Recovery Rating 2(85%)

Senior Unsecured B+

Recovery Rating 2(85%)

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.

Copyright © 2021 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.