Fitch Downgrades TDC to 'BBB-'; Outlook Stable

Fitch Ratings, London, 17 December 2015: Fitch Ratings has downgraded Denmark-based TDC A/S's (TDC) Long-term Issuer Default Rating (IDR) and senior unsecured rating to 'BBB-' from 'BBB'. The Outlook on the IDR is Stable. A full list of ratings action is below.

The downgrade reflects Fitch's expectations that following the company's acquisition of Norwegian cable operator Get, the pace of deleveraging will be slower than originally expected. This is due to ongoing weakness in TDC's domestic operations as a result of competitive and regulatory pressures impacting revenues and margins. The Stable Outlook reflects Fitch's expectations that domestic EBITDA is likely to stabilise by 2018 and that the company has headroom in its key credit metrics within its 'BBB-' rating.

KEY RATING DRIVERS

Domestic Weakness

TDC's domestic EBITDA declined in 9M15 by 10.7% YoY. The decline has been driven by a combination of competitive pressure in the consumer mobile and business segments, the loss of wholesale mobile virtual network (MVNO) contracts and regulatory pressure on broadband wholesale prices and retail roaming. Fitch expects these pressures will persist into 2016 leading to further significant declines in EBTIDA driven by revenue loss and margin contraction. TDC has indicated limited scope to reduce costs in its domestic market in the short term.

Our forecasts assume that the rate of EBITDA decline will reduce in 2017 and potentially stabilise in 2018. This is based on the repricing within the business segment coming to an end, lower incremental impact from regulation and a more rationale competitive environment developing in the consumer mobile sector. TDC has recently raised mobile prices, a move that has to some extent been followed by its competitors. TeliaSonera and Telenor, the number 2 and 3 operators in Denmark currently have low EBITDA margins of 10% and 12% (1H15), respectively, which are not sustainable in the medium to long term, in our opinion.

Managing Acquisition-Induced Leverage

TDC's acquisition of Norwegian cable operator Get raised its funds from operations (FFO) net adjusted leverage to 4.7x in YE2014 (assuming the consolidation of GET from November 2014) from 3.4x in September 2014. At the time of the acquisition, we expected leverage would decline to 3.7x by 2017. With the weakness in domestic EBITDA we expect TDC's FFO net adjusted leverage to now remain elevated but broadly stable, between 3.9x and 4.1x until 2017. This assumes some reduction in dividends. If the company is able to stabilise its EBITDA in 2018, this will allow TDC to reduce FFO-adjusted net leverage to a pace of 0.2x per year, assuming capital intensity levels remain stable.

Domestic Fixed Line Supportive

TDC owns both the Danish incumbent copper network and the majority of the cable infrastructure in the country. This gives the company a strong fixed line position compared with all other European incumbents and helps the company to generate domestic EBITDA margins of 44% in 9M15, including headquarter costs. The position is likely to be structurally supportive to TDC's medium- to long-term financial profile due to a lack of alternative fixed line infrastructures and is reflected in Fitch-calculated FFO-adjusted net leverage downgrade guidance of 4.25x, which is at the higher end of the rating category. Current competitive pressures are more prevalent in the mobile and business segments.

KEY ASSUMPTIONS
Fitch's key assumptions within our rating case for the issuer include:
- Revenue increase of 4.6% in FY15, driven by the acquisition of Get, declines of 2.5% in FY16 before gradually stabilising in 2018.
- EBITDA margin of 40.7% in 2015 reducing to 38% over 2016-18.
- CAPEX stable at 4.2-4.3bn per year over the next three years.
- A conservative approach to dividend policy.

RATING SENSITIVITIES
Positive: Future developments that may, individually or collectively, lead to positive rating action include:
- The expectation that FFO adjusted net leverage will trend below 3.75x on a sustained basis.
- An improvement in TDC's domestic operating environment enabling a stabilisation in domestic EBITDA.

Negative: Future developments that may, individually or collectively, lead to negative rating action include:
- FFO adjusted net leverage trending above 4.25x on a sustained basis.
- Further declines in the domestic business putting group pre-dividend FCF margins under pressure into the mid-single digit range.

FULL LIST OF RATING ACTIONS

- Long-term IDR: downgraded to 'BBB-' from 'BBB'; Outlook Stable
- Senior unsecured notes: downgraded to 'BBB-' from 'BBB'
- Short-term IDR affirmed at 'F3'
- Subordinated hybrid securities: downgraded to 'BB' from '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.