

CREDIT FOCUS

RATINGS

TDC A/S

LT Issuer Rating	Baa2
Outlook	Stable

KEY INDICATORS

	Dec 30 2010	Dec 31 2011	Dec 31 2012
Revenues (DKKbn)	26.2	26.3	26.1
EBITDA Margin %	41.2%	44.9%	41.8%
Debt/EBITDA	2.8x	2.4x	2.7x
RCF/Debt	30.4%	21.5%	16.8%

Source: Moody's Financial Metrics, as adjusted

Analyst Contacts:

MADRID +34.91.768.8200

Carlos Winzer +34.91.768.8238
Senior Vice President
carlos.winzer@moodys.com

Ivan Palacios +34.91.768.8229
Vice President – Senior Credit Officer
ivan.palacios@moodys.com

LONDON +44.20.7772.5454

Paloma San Valentin +44.20.7772.1385
Managing Director - Corporate Finance
paloma.sanvalentin@moodys.com

TDC A/S: Atypical Business Profile Is Key to Resilient Credit Profile

Summary

- » **TDC A/S (Baa2 stable) is amongst the most resilient telecoms operators in Europe.** The company emerged from non-investment grade two years ago, aided by a unique business model that integrates its telecom and cable TV (CATV) businesses. TDC differentiates itself from its European peers by virtue of the fact that it is one of the few telecoms operators in Europe with a CATV business.
- » **The company has adopted a high dividend payout policy, which uses up cash and affects financial ratios.** However, this policy operates within a fairly prudent financial strategy.
- » **TDC is a fairly small company with low international diversification, which exposes it to a mature domestic market.** Given the company's small size and limited international diversification, it could become an M&A target.
- » **The company's operating performance is strong, with high and sustainable margins.** This strong performance is supported by management's ability to execute a strategy focusing on bundled services at attractive prices.
- » **TDC exhibits moderate technology risk.** This level of risk is supported by the company's gradual investment to transform both its telecom and CATV networks into enhanced broadband networks, coupled with its gradual and efficient migration from copper to fibre technologies.
- » **Despite the challenging operating environment, we consider TDC's rating to be well positioned.** The rating and stable outlook reflect our expectation that the company will maintain strong cash flow generation through a combination of operating stability, efficiency gains and capex optimisation. We have incorporated in the rating our expectation that TDC's credit metrics will gradually improve.

TDC is amongst the most resilient telecoms operators in Europe

The strategic combination of TDC's CATV network and its telecom network represents one of the critical success factors of the company. This business model, together with the profound restructuring process that the company has undergone, has strongly positioned TDC as one of the most resilient telecoms operators in Europe. These factors offset TDC's financial risk, including a very high dividend payout policy, which constrains the company's financial ratios. This financial risk, combined with the company's small size relative to that of its European peers and the competitive nature of the Danish market, constrains the rating.

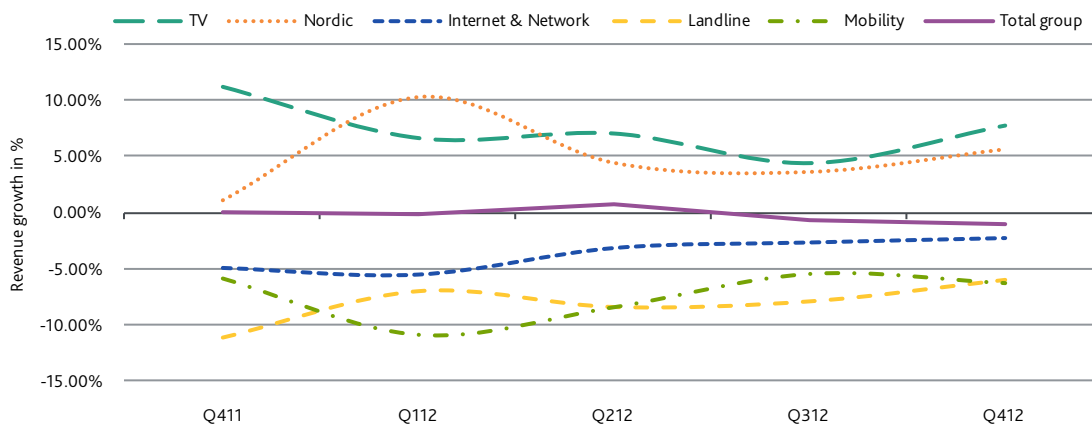
In Europe, most incumbent telecoms operators possess networks that support the provision of voice as well as broadband transmission, including internet protocol TV (IPTV) services via their broadband triple-play offers. Historically, most incumbents also installed the cable networks technology that enabled them to offer CATV services. However, regulators ordered these companies to spin off their CATV businesses in order to facilitate competition.

TDC stands out from the usual telecom business profile by owning its own CATV network in addition to its fixed and mobile networks. This particularity arose from the decision of the Danish government to privatise the telecommunications industry in the early 1990s. In 1990, the government merged the four regional telecommunications companies, together with Telecom A/S, under a new holding entity, Tele Danmark.

TDC has now increased its market share of the Danish pay-TV segment, and as of 31 December 2012 reported a combined market share of 52% (combined with YouSee). The second-largest CATV operator, Stofa, had an estimated 14% market share as of 31 December 2012. This dominant position confers diversified revenue growth potential for TDC, and the company now also has two strong infrastructure-based networks supporting two different but complementary business models (telecoms and CATV).

As observed within the whole industry, TDC was adversely affected by the decrease in mobile and fixed-line subscriptions over the past few years, which was mainly a result of regulatory cuts. However, the company was able to minimise this decline by delivering strong growth in its Nordic division, and in its CATV segment in particular. Exhibit 1 illustrates the declining trend in revenues in TDC's Broadband, Fixed-line and Mobile voice divisions, and the growth trend in its TV (CATV and IPTV) and Nordic segments.

EXHIBIT 1

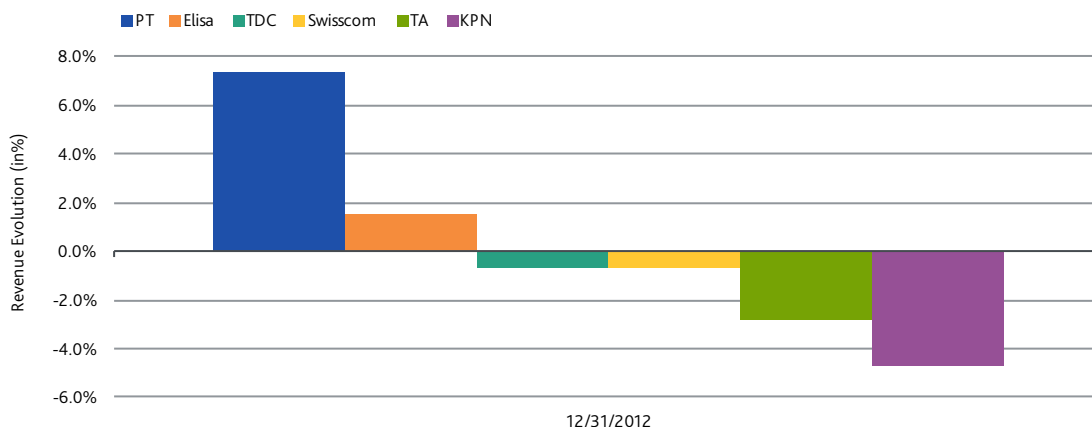
TDC's Organic Revenue Growth Is Driven by TV

Source: TDC Annual Report 2012

In 2012, the company's main sources of revenue growth were its Consumer and Nordic divisions, as well as the TV (CATV and IPTV) segment, where the increase was the most perceptible, with a 3% increase in revenue-generating units year-on-year as of 31 December 2012, and an overall increase in revenue of 9.8% year-on-year at the same date. This growth compensated for the noticeable decline in revenues in the company's Business segment.

In 2012, TDC was also affected by regulation, which included cuts in mobile termination rates (MTRs) and roaming charges. Indeed, the 0.7% decline in TDC's revenue in 2012 is largely attributable to these regulatory cuts, putting the company in a unique position in Europe, where it maintained stable top-line revenues, as shown in Exhibit 2.

EXHIBIT 2

TDC's Year-on-Year Revenue Growth in 2012 Was Less Volatile Compared with Some of its Rated Peers

Source: Moody's Financial Metrics, as adjusted by Moody's

Through its multi-brand strategy, TDC has retained strong market shares as a leading telecoms operator in Denmark providing traditional fixed-line, internet and mobile services. In addition, it is the largest provider of cable services in Denmark under its brand YouSee. TDC has a good competitive position, as we note that other cable operators represent a growing threat for European

broadband/fibre operators. According to its financial report for 2012, as of 31 December of that year TDC had an 81% market share in landline telephony, a 60% landline broadband market share, a 52% market share in TV (combining YouSee and TDC), and a 42% market share in mobile voice services, which positions the company as the market leader in all four of the aforementioned segments in Denmark.

The company has adopted a high dividend payout policy, which uses up cash and affects financial ratios

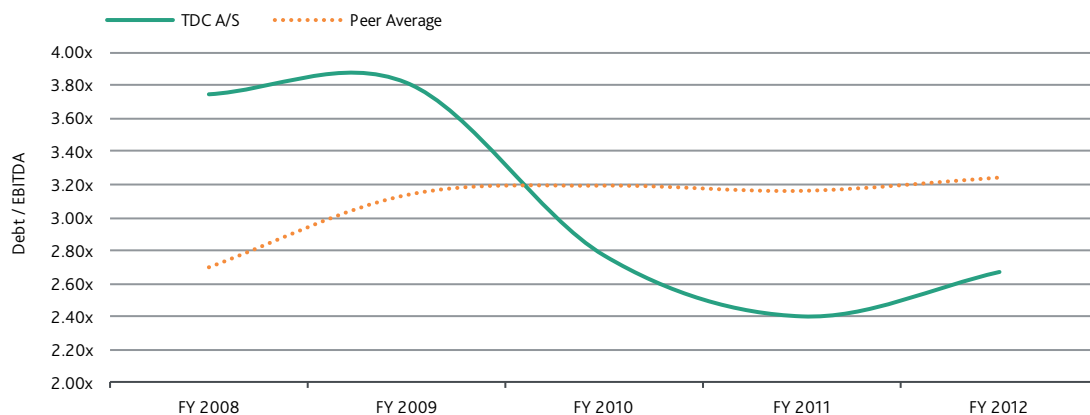
TDC's high dividend payout policy represents a credit weakness for the company. The highly attractive shareholder remuneration policy is a result of the high cash flow generation and management's policy to balance shareholder returns and an efficient financial profile. Although the shareholder remuneration policy operates within a fairly prudent financial strategy that includes maximum leverage – measured as reported net debt/EBITDA before pension income ratio – of 2.2x on average over the financial year, the high dividend payout weakens the company's free cash flow (FCF).

TDC's publicly stated payout ratio target of 90% of equity FCF (as defined by the company) will constrain management's ability to strengthen the company's debt protection ratios, mainly FCF/debt and retained cash flow (RCF)/debt. However, we expect TDC's low RCF and FCF levels to be partially offset by (1) the company's strong ongoing commitment to a financial strategy that includes a public commitment to preserving an investment-grade rating and a committed maximum leverage; (2) its limited use of its financial strength (we note the company's intention to comply with its leverage target, and we believe that any potential acquisitions will be bolt-on in nature and undertaken within guidance metrics for the current rating); and (3) the strong liquidity that we expect the company to preserve at all times in order to avoid any funding constraints.

Despite TDC's high dividend payout policy, the company has been able to sustain adequate financial ratios for the current rating category. This is supported by the steep debt reduction from 2009 through 2011 (see Exhibit 3), demonstrating management's commitment to a conservative credit profile. The change in the declining trend in TDC's adjusted gross debt/EBITDA ratio in 2012, as seen in Exhibit 3, primarily reflects that although adjusted funds from operations continued to improve that year, gross adjusted debt increased by DKK835 million (€112 million), mainly as a result of increased operating leases. The company's EBITDA was negatively affected by the change in accounting related to an interest hedge. In addition, TDC used most of its cash flow to fund its increased dividend payment in 2012 of DKK3.59 billion (€480 million) and therefore not for debt reductions. We have incorporated in the rating our expectation that TDC's credit metrics will gradually improve.

As of 31 December 2012, TDC paid a strong DKK4.60 (€0.60) per share, with investors receiving a total of DKK3.59 billion (€480 million), an impressive 80% payout of equity FCF. The company's equity FCF fell just 3.2% in 2012 compared with 2011, to DKK4.45 billion (€600 million), and was positively affected by the positive change in net working capital (DKK197 million, or €26 million) related to a change in smartphone financing, whereby TDC sold its receivables to a bank.

EXHIBIT 3

TDC's Leverage Expected to Continue to Decrease Over Time

Source: Moody's Financial Metrics, as adjusted by Moody's. Peer group includes KPN, Swisscom, Elisa, Telekom Austria and Portugal Telecom.

In the past few months, we have witnessed an increasing number of announcements from issuers in the telecoms industry regarding reductions in dividends, as illustrated by the recent dividend cuts announced by Telekom Austria (Baa1 negative) and Telecom Italia (Baa3 negative). However, while dividend cuts have become common practice, TDC has defied this trend and it is therefore able to maintain a high dividend/FCF ratio, albeit the company announced a slight decrease in November 2012 (to DKK3.70 per share for 2013 from DKK4.60 for 2012).

TDC is a fairly small company with low international diversification, which exposes it to a mature domestic market

TDC is a fairly small company with low international diversification, which exposes it to a mature domestic market. Part of TDC's recent restructuring process consisted of the sale of international subsidiaries, as these were not considered core assets.

TDC's reduction in size following the recent divestments renders the company vulnerable to a possible takeover scenario in the next 18-24 months against the background of industry consolidation. In our opinion, TDC's status as a non-government entity, its small size and its attractive cash flow, makes it a target for an acquisition.

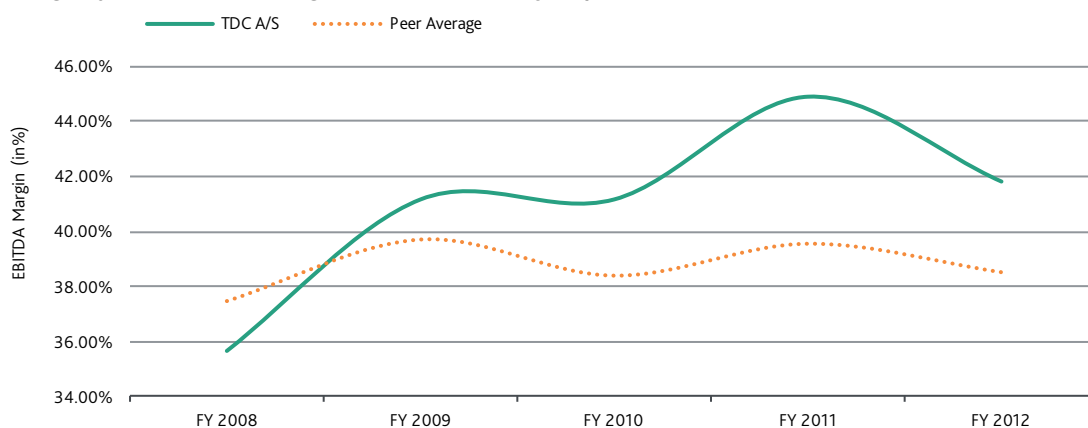
In the full year ending 31 December 2012, TDC generated revenues of DKK26.10 billion (approximately €3.50 billion), solely from Denmark and the Nordic regions. The company has witnessed an increase in average revenue per user (ARPU) in the Consumer segment, which compensated for the decrease in ARPU in the Business segment. We expect the company to report a slight decline in revenues for 2013 in Denmark. However, TDC may offset the further contraction in its domestic Fixed-line business with growth in the Mobile voice, TV (CATV and IPTV) and Nordic businesses. From 2014 onwards, we expect TDC's revenues to be stable or to slightly increase as the company benefits from a smaller regulatory impact and its integrated strategy, which includes promoting enhanced product bundles and tiered-pricing schemes. We expect the company to report growth in the TV (CATV and IPTV) and Nordic segments, i.e., those segments that have recorded strong growth in the recent years.

The company's operating performance is strong, with high and sustainable margins

The company's strong operating performance is supported by management's ability to execute a strategy focusing on bundled services at attractive prices. TDC has largely resisted the global negative trend in revenues exhibited throughout the sector in Europe, maintaining only slight declines (0.7% reduction) in revenues in the full year ending 31 December 2012. We believe that the company will be able to continue to offset much of the impact of possible further price erosion by the continued focus on (1) efficiency improvements (for the 12 months to December 2012, the company reduced its operating expenditure by approximately 5.6% compared with the 12 months to December 2011); and (2) differentiation through service quality and breadth of product offering, strengthening the company's position in the domestic pay-TV markets. We note that the recent restructuring processes implemented by TDC, including the disposal of assets and subsidiaries (Sunrise, B1 stable) as well the process of reengineering and employee reductions, have already enabled the company to achieve and sustain a reported EBITDA margin of around 40%, or approximately 42% as adjusted by Moody's (see Exhibit 4).

EXHIBIT 4

Strong Adjusted EBITDA Margin Reflects Efficiency Improvements



Source: Moody's Financial Metrics, as adjusted by Moody's. Peer group includes KPN, Swisscom, Elisa, Telekom Austria and Portugal Telecom.

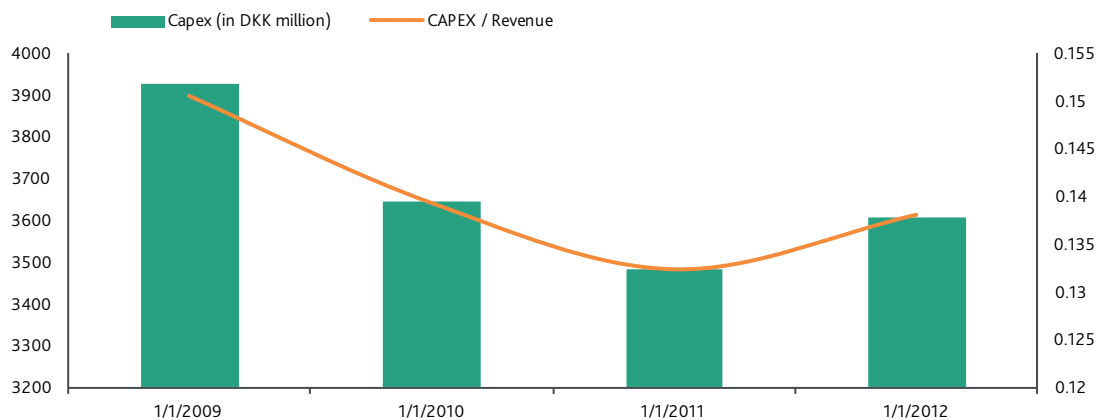
TDC exhibits moderate technology risk

Our assessment of moderate technology risk for TDC is supported by the company's gradual investment to transform both its telecom and CATV networks into broadband networks, by efficiently deploying those technologies migrating from copper to fibre.

The combination of a highly advanced infrastructure, including cable ownership, provides TDC with strong network platforms both in fixed line and mobile. Over the past three years, TDC's reported capital expenditure (capex)/revenue has been below 15%, and we expect this metric to increase slightly over the next few years. We expect that TDC's annual capex will increase by DKK200 million (around €27 million) to around DKK3.70 billion (approximately €500 million) in 2013, and will be sustained over the next three years (see Exhibit 5).

EXHIBIT 5

Past High Capex Reflects Moderate Technology Risk



Source: Source: Moody's Financial Metrics, as Reported

TDC operates both a CATV and a telecom network simultaneously, which differentiates it from its peers in the industry, enabling it to segment and select the market, offering different technologies depending on demand and competition. For example, according to TDC, as of 31 December 2012 45% of households were able to receive internet download speeds of up to 100 megabits per second, or Mbps (source: TDC Q4 presentation).

In the 12 months ended 31 December 2012, the company's TV segment (CATV and IPTV) reported a DKK351 million (€47 million) increase in revenues to DKK3.90 billion, or €528 million (up 9.8% year-on-year), and DKK134 million (€18 million) growth in gross profit to DKK2.19 billion, or €294 million (up 6.5% year-on-year). This growth was mainly driven by the increase in subscription fee at the beginning of 2012.

In the past three years, TDC has reported -1% to 1% annual growth in revenues, with cable operations being one of the main drivers of the company's results. We expect TDC's cable business to maintain this trend, with a moderate increase in revenues in 2013 and 2014. In our view, this growth will be driven by several factors: (1) on 1 January of each year, there is an indexation of price plans, which drives up cable revenues; (2) TDC's launch of new 'over-the-top (OTT) content' digital services; (3) improved and additional content; and (4) increased broadband penetration in the company's cable customer base (which was around 36% as of 31 December 2012).

Although we expect TDC to report revenue growth in its CATV segment, we have identified the following potential risks that could mitigate the growth expectations: (1) the Danish Business Authority and the Danish Agency for Digitisation (i.e., the regulatory bodies in charge of the telecom industries since 3 October 2011) may in the future exert pressure on TDC to spin off its cable operations, although currently there is no indication that this will be the case; and (2) high-end customers may migrate towards lower-price packages by selecting specific add-on features, reducing the overall price of their packages.

Despite the challenging operating environment, we consider TDC's rating to be well positioned

TDC's rating reflects (1) the strength of the company's operations in Denmark (strong market shares including more than 42% in its Mobile voice segment) and the Nordic countries; (2) a clear strategy that has been recently revised and focused on enhancing network quality to deliver product bundles in support of revenues; (3) a track record of delivering stated results; (4) the quality of management and business model; (5) the strategic fit and importance of all of TDC's subsidiaries, particularly its CATV business (YouSee), which differentiates the company from its European peers; (6) its financial strength, which is underpinned by expected substantial operating cash flow generation; and (7) appropriate liquidity risk management. The rating also reflects TDC's low international diversification and fairly small size.

In addition, the rating reflects our expectation that the company will adhere to its publicly stated commitment to maintain maximum leverage of reported net debt/EBITDA of 2.2x (approximately equivalent to a Moody's-adjusted gross ratio of 2.7x). Furthermore, the rating reflects TDC's generous shareholder distribution policy, which significantly erodes cash flow after dividend as seen in the RCF/adjusted debt and FCF/adjusted debt.

The stable outlook on the rating reflects our expectation that TDC will maintain strong cash flow generation after capex through a combination of operating stability, efficiency gains and capex optimisation. We expect the company to maintain a strong operating performance with high and sustainable margins. The outlook also reflects our expectation that TDC will maintain financial metrics that are commensurate with a Baa2 rating, including adjusted RCF/gross debt trending towards 20% and gross adjusted debt/EBITDA of below 2.5x.

Negative pressure could be exerted on the ratings if TDC's financial metrics deteriorate as a result of weak operating performance or an extraordinary use of funding that translates into adjusted debt/EBITDA exceeding 2.5x or adjusted RCF/debt consistently below 17%, with unclear signs of improvement.

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Authors
 Carlos Winzer
 Arnaud Martel

Editor
 Simon Culshaw

Production Associate
 Alisa Llorens

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