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TDC A/S

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Major Rating Factors

Corporate Credit Rating
BBB/Positive/A-2

Strengths:

- Position as leading operator in the Danish fixed-line, cable, and mobile telecoms markets.
- Good track record of improving operating efficiencies.
- Solid generation of free operating cash flow.

Weaknesses:

- Limited revenue growth prospects in the mature Danish telecoms market.
- Controlling stake still held by private-equity sponsors.
- Our anticipation of modest discretionary cash flows given a commitment to shareholder distribution.

Rationale

The ratings on Danish telecommunications operator TDC A/S reflect Standard & Poor's Ratings Services' opinion of the company's satisfactory business risk profile and intermediate financial risk profile. This opinion is underpinned by TDC's position as the leading operator in the Danish telecoms market; strong track record of improving operating efficiency and our expectation of further improvements; a moderately conservative financial policy; and good free operating cash flow (FOCF) generation.

These factors are partly offset by our view that there is limited potential for revenue growth in the mature and competitive Danish telecoms market. Another constraining factor is the group's private-equity ownership, with NTC Holding G.P. & Cie S.C.A. and related parties (NTC) remaining TDC's main owner despite a recent ownership reduction to 43.3%, and TDC's lack of track record in adhering to its financial policy in times of operational stress or distressed financial markets. Furthermore, we anticipate that TDC will likely generate only modest discretionary cash flow after dividends in the medium term.

Key business and profitability developments

We expect TDC's consolidated revenues to grow over the next two years, though at a low single-digit rate, reflecting modest growth prospects in the mature Danish telecom market. However, we think that TDC could benefit from growth in its domestic TV operations and in the Nordic corporate segment. Although growth prospects in mobile data services are supported by increasing penetration of smartphones, growth in the mobile operations could prove more challenging given a very competitive landscape with four players in a small market, and ongoing price decline in traditional voice and messaging revenues. We expect TDC to maintain its strong domestic positions in all segments given its technological expertise and strong brand recognition.

TDC has a strong record of improving operating efficiency; its EBITDA margin increased to 41.6% in 2011 from 33.5% in 2007 according to the company's calculations, which exclude special items, notably restructuring costs. After Standard & Poor's adjustments, we calculate the 2011 EBITDA margin at 37.8%, and we believe it could further increase toward 40% over the next two years as a result of additional cost cutting.

Key cash flow and capital-structure developments

We expect adjusted net debt-to-EBITDA to decrease towards 2.5x in 2013 from 2.8x in 2011. Despite TDC's good FOCF generation, we expect deleveraging potential to remain constrained by the company's dividend payout policy -- 80%-85% of equity free cash flow, excluding special items -- and we forecast discretionary cash flow (FOCF after dividends) will be modest in 2012 and 2013. In addition, we understand that TDC may implement share buybacks so that its ratio of net debt to EBITDA before pension income could occasionally come close to its maximum 2.2x target, which could translate into maximum leverage at 2.6x-2.7x (adjusted by Standard & Poor's). This is because we believe the difference between adjusted leverage and TDC's net debt-to-EBITDA ratio could slightly decrease (from 0.8x in 2011) if restructuring costs decline over time. TDC's recently restated target of 2.2x using net debt-to-EBITDA before pension income has no impact on our calculations.

A recent ownership reduction by private-equity owner NTC to 43.3% from 59.1% is positive in our view. However, NTC remains TDC's main owner and there is no indication of any further reduction or the impact such a reduction would have on TDC's financial policy.

Liquidity

The short-term rating is 'A-2'. TDC's liquidity is "strong," according to our criteria, reflecting our anticipation that liquidity sources will cover liquidity uses by at least 1.5x over the next 12 months, and by at least 1x over the next 24 months.

The company's liquidity sources consist of:

- Surplus cash of at least DKK1 billion over the next two years. As of Dec. 31, 2011, the company's liquid assets totaled DKK1.5 billion.
- An undrawn committed unsecured revolving credit facility of €500 million (DKK3.7 billion) due 2016.
- Two €100 million committed unsecured bilateral facilities (DKK1.5 billion combined, of which about DKK1.3 billion is currently undrawn) due 2014.
- Cash flows from operations at about DKK7.5 billion per year over the next two years (from DKK7.2 billion in 2011).
- A new 10-year €500 million (DKK3.7 billion) bond issued in March 2012.

Against these sources, we anticipate the following liquidity uses:

- Annual capital expenditures of about DKK3.5 billion.
- Annual dividends of DKK3.7 billion.
- A €457 million (DKK3.4 billion) bond maturing in April 2012.

The company has no other debt maturities in 2012 and 2013.

Backup facilities include a maintenance financial covenant that would only be triggered if the long-term rating were to become speculative grade.

Outlook

The positive outlook reflects the possibility of an upgrade over the next two years by one-notch if the company's EBITDA margin -- as adjusted by Standard & Poor's -- remains comfortably in the 38%-40% range, with adjusted debt to EBITDA sustainably declining to about 2.5x.

We could revise the outlook to stable if revenues were to decline as a result of competitive or regulatory pressure, if TDC were unable to sustain its profitability improvements, or if the company were to adopt a more aggressive financial policy than that reflected by its current unadjusted net debt to EBITDA target of 2.2x, resulting for instance in adjusted debt to EBITDA above 2.7x.

Business Description

TDC is the leading provider of telecommunications solutions in Denmark and is present throughout the Nordic market.

Following the divestment of a 15.8% stake in February 2012, TDC is now 43.3%-owned by private-equity sponsors (Apax Partners Worldwide LLP, The Blackstone Group International Ltd., Kohlberg Kravis Roberts & Co. L.P., Permira Advisers KB, and Providence Equity Partners Ltd.), through NTC. The remainder is free float, with Singapore Investment Corp. holding more than 5%.

Business Risk Profile: Strong Domestic Market Position, But Limited Growth Prospects

The main strengths for the group's "satisfactory" business risk profile, according to our classifications, are:

- The ownership of copper pair, cable, fiber, and mobile networks. TDC is one of the few telecoms incumbents to own the leading domestic cable network, which is an important positive factor for its business risk profile, because cable platforms represent an attractive alternative infrastructure competing with telephony lines in the provision of TV, broadband, and fixed-line telephony services. According to TDC, its cable network covered about 58% of Danish households as of year-end 2011. Furthermore, TDC owns a fiber network in the greater Copenhagen area so we believe the group is well positioned to resist competition from Danish utility companies that have made substantial investments in the roll-out of fiber to the home networks in recent years.
- An established and strong domestic position in the business and residential customer segments. As of year-end 2011, TDC had relatively high and sustainable market shares in fixed-line (about 81% in public switched telephone network and 58% in voice over Internet protocol [VoIP] telephony subscriptions), fixed-line broadband Internet (60%), and mobile voice (44%) subscriptions, according to company estimates. TDC estimated that it had a subscriber market share of about 55% for pay-TV services through its Internet protocol TV and cable operations.
- A strong cost-cutting track record. A flexible domestic labor market, technological expertise, and strong brand recognition enable TDC to achieve solid operating margins and sustainable free cash flow, in our view. We believe that TDC could achieve further profitability improvements.

These strengths are partly offset by:

- Limited growth prospects in the mature and relatively small Danish telecoms market (5.5 million inhabitants). We believe the Danish market offers limited growth prospects because of continuously declining traditional landline telephony revenues, resulting from the migration of customers to mobile and VoIP services, and the already very high penetration rate for broadband Internet services. However, this could be offset by growth in domestic TV operations, Nordic corporate operations, and growth in mobile data services, which is supported by the increasing penetration of smartphones (about 75% of all mobile devices sold in Denmark are now smartphones according to TDC).

- Meaningful competition from financially strong telecom operators in Denmark. TDC's main competitors are the Norwegian incumbent operator Telenor ASA (A-/Stable/A-2) and the Swedish incumbent TeliaSonera AB (A-/Stable/A-2). Competition is particularly severe for mobile telephony and broadband services, where TDC also faces meaningful competition from a fourth mobile network operator, Hi3G Denmark ApS. TDC is the leader but with a market share of only 35% in data-only mobile broadband subscriptions in Denmark at the end of 2011, according to the company.
- Moderate regulatory pressure. In our view, regulation in Denmark is in line with average levels in the EU and further price cuts, notably for data roaming and mobile termination rates, will occur in 2012. However, according to TDC, the impact on gross profit will be minor. Since 2011, TDC has been obliged to open its cable network to competitors to allow them to compete with TDC on equal terms for broadband Internet customers but no request from competitors has been received so far.
- Limited geographic diversity. Although TDC operates across the Nordic region, we believe the company has a relatively weak competitive position outside Denmark for business-to-business services. Despite a solid broadband backbone network--which allows TDC to provide data, Internet, and voice traffic to business customers throughout the Nordic region--we currently view TDC as a challenger for business-to-business telecom services outside its domestic market.

Financial Risk Profile: Strong Cash Flow But Aggressive Shareholder Remuneration

The main strengths of the company's "intermediate" financial risk profile, according to our classifications, are:

- Solid FOCF generation despite sizable capital expenditures to maintain its competitive position in the Danish telecoms market. TDC is likely to acquire a 800 MHz spectrum in 2012 to roll-out 4G services but we believe that the cost could be low compared with those of several European peers and that payments could be split over several years.
- Relatively conservative financial policy guidelines, which target 2.2x maximum unadjusted net debt to EBITDA before pension income (this recently revised target is equivalent to the former 2.1x maximum unadjusted net debt to EBITDA according to TDC and has no impact on our calculations as we exclude pension income from EBITDA).
- Strong liquidity and a long-dated maturity structure after a recent bond issuance.

These weaknesses are offset by:

- TDC's policy of distributing 80%-85% of free cash flow before restructuring charges, which, after the latter are factored in, should translate into the bulk of free cash flows being distributed to shareholders.
- A controlling stake held by private-equity sponsors and a lack of track record in adhering to recently introduced financial policy guidelines.

Financial Statistics/Adjustments

TDC produces consolidated financial statements in accordance with International Financial Reporting Standards. In our assessment of the company's financial leverage, we make our usual asset-retirement and operating lease obligation adjustments to TDC's reported figures (see table 1). We also deduct restructuring costs from TDC's operating income because we view these costs as recurring expenses.

Given the narrow geographic focus, we think most reported cash balances are likely to be available at the parent in the future, and therefore we net reported gross debt with cash.

Table 1

Reconciliation Of TDC A/S Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. DKK)

	--Fiscal year ended Dec. 31, 2011--						
TDC A/S reported amounts							
	Debt	**Shareholders' equity**	**Revenues**	**EBITDA**	**Operating income**	**Interest expense**	**Cash flow from operations**
Reported	23,220.0	22,244.0	26,304.0	10,940.0	5,713.0	1,204.0	7,177.0
Standard & Poor's adjustments							
Operating leases	5,555.9	--	--	323.2	323.2	323.2	495.8
Postretirement benefit obligations	--	--	--	(438.0)	(438.0)	--	195.8
Surplus cash and near cash investments	(1,489.0)	--	--	--	--	--	--
Asset retirement obligations	108.0	--	--	--	--	--	--
Reclassification of nonoperating income (expenses)	--	--	--	--	22.0	--	--
Reclassification of interest, dividend, and tax cash flows	--	--	--	--	--	--	4.0
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--
Restructuring costs	--	--	--	(885.0)	(885.0)	--	--
Total adjustments	4,174.9	0.0	0.0	(999.8)	(977.8)	323.2	695.6
Standard & Poor's adjusted amounts							
	Debt	**Equity**	**Revenues**	**EBITDA**	**EBIT**	**Interest expense**	**Cash flow from operations**
Adjusted	27,394.9	22,244.0	26,304.0	9,940.2	4,735.2	1,527.2	7,872.6

Table 2

TDC A/S -- Peer Comparison

	TDC A/S	**TeliaSonera AB**	**Koninklijke KPN N.V.**	**Elisa Corp.**
Rating as of March 26, 2012	BBB/Positive/A-2	A-/Stable/A-2	BBB/Stable/A-2	BBB/Stable/A-2
	--Fiscal year ended Dec. 31, 2011--			
(Mil. €)				
Revenues	3,538.8	11,726.5	13,022.0	1,530.0
EBITDA	1,337.3	4,179.3	5,090.6	516.9

Table 2

TDC A/S -- Peer Comparison (cont.)				
Net income from cont. oper.	378.4	2,061.0	1,549.0	201.4
Funds from operations (FFO)	1,068.1	3,490.5	4,358.7	450.4
Capital expenditures	582.3	2,293.2	2,637.0	242.4
Free operating cash flow	476.7	991.5	1,814.7	177.2
Discretionary cash flow	237.2	(676.0)	614.7	(25.6)
Cash and short-term investments	0.0	29.1	250.0	0.0
Debt	3,685.6	9,791.8	16,006.3	867.9
Equity	2,992.6	13,581.7	2,346.7	837.6
Adjusted ratios				
EBITDA margin (%)	37.8	35.6	39.1	33.8
EBITDA interest coverage (x)	6.5	11.1	6.4	11.9
EBIT interest coverage (x)	3.1	9.1	3.2	7.0
Return on capital (%)	8.5	14.2	13.1	17.8
FFO/debt (%)	29.0	35.6	27.2	51.9
Free operating cash flow/debt (%)	12.9	10.1	11.3	20.4
Debt/EBITDA (x)	2.8	2.3	3.1	1.7
Total debt/debt plus equity (%)	55.2	41.9	87.2	50.9

Table 3

TDC A/S -- Financial Summary			
	--Fiscal year ended Dec. 31--		
	2011	**2010**	**2009**
Rating history	BBB/Stable/A-2	BBB/Stable/A-2	BB-/Positive/B
(Mil. DKK)			
Revenues	26,304.0	26,167.0	35,939.0
EBITDA	9,940.2	9,545.9	12,233.8
Net income from continuing operations	2,813.0	1,804.0	2,788.0
Funds from operations (FFO)	7,939.6	7,566.6	10,110.7
Capital expenditures	4,316.1	3,646.0	5,645.2
Free operating cash flow	3,556.5	4,491.6	5,500.5
Discretionary cash flow	1,776.5	4,421.6	(2,489.5)
Cash and short-term investments	0.0	0.0	763.0
Debt	27,394.9	28,146.6	53,244.8
Equity	22,244.0	20,855.0	27,078.0
Adjusted ratios			
EBITDA margin (%)	37.8	36.5	34.0
EBITDA interest coverage (x)	6.5	5.9	5.1
EBIT interest coverage (x)	3.1	2.7	3.0
Return on capital (%)	8.5	6.0	8.7
FFO/debt (%)	29.0	26.9	19.0
Free operating cash flow/debt (%)	13.0	16.0	10.3
Debt/EBITDA (x)	2.8	2.9	4.4

Table 3

TDC A/S -- Financial Summary (cont.)			
Debt/debt and equity (%)	55.2	57.4	66.3

Ratings Detail (As Of March 26, 2012)	
TDC A/S	
Corporate Credit Rating	BBB/Positive/A-2
Senior Unsecured (7 Issues)	BBB
Corporate Credit Ratings History	
16-Mar-2012	BBB/Positive/A-2
15-Dec-2010	BBB/Stable/A-2
20-Sep-2010	BB/Watch Pos/B
14-Jun-2010	BB/Positive/B
26-Nov-2009	BB-/Positive/B
Business Risk Profile	Satisfactory
Financial Risk Profile	Intermediate
Debt Maturities	
As of March 2012: 2011: Nil 2012: DKK3.4 bil. 2013: Nil 2014: Nil 2015: DKK8 bil. Thereafter: DKK14.6 bil.	

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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