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## Research Update:

# Danish Telecom TDC Outlook Revised To Stable From Positive On Weaker Revenue And Credit Metrics; 'BBB' Rating Affirmed

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## Overview

- TDC's results for 2013 were weaker than we expected, and we anticipate further declines in 2014-2015.
- In addition, we expect the debt-to-EBITDA ratio to deteriorate slightly to 2.7x-2.8x over the next two years, which is not commensurate with a higher rating.
- We are therefore revising our outlook on TDC to stable from positive and affirming our 'BBB/A-2' ratings.
- The stable outlook reflects our anticipation that TDC's revenues and EBITDA will only modestly decline and gradually stabilize over the next two years.

## Rating Action

On March 18, 2014, Standard & Poor's Ratings Services revised its outlook on Danish telecommunications operator TDC A/S to stable from positive. At the same time, we affirmed our 'BBB' long-term and 'A-2' short-term corporate credit ratings on the company.

## Rationale

The outlook revision reflects our expectation that in 2014-2015 TDC's revenue and EBITDA will continue to decline, albeit at a slower pace than in 2013, and that its credit metrics will deteriorate slightly. We now expect the group's revenues to decrease by low single digits, compared with our previous forecast of stable revenue following a 5.8% decline in 2013. We base our revised projections primarily on the continued decline in fixed telephony and likely lower revenues as a result of regulatory changes over the next two years. However, we believe that, from 2016, TDC's revenues could stabilize or increase slightly as the impact from those negative factors diminishes. We anticipate further modest profitability improvements, but not enough to offset the revenue decline over the next two years.

Under our revised base-case scenario, we expect adjusted EBITDA and free operating cash flow (FOCF) to decline in 2014 compared with 2013. Given TDC's policy of distributing approximately 90% of free cash flow after special items as dividends, we anticipate only modest discretionary cash flows (DCF) and therefore a modest increase of the adjusted debt-to-EBITDA ratio to about


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2.7x-2.8x, from 2.7x at year-end 2013.

We continue to assess TDC's business risk profile as "satisfactory," given its strong position as the leading operator in Denmark's fixed-line, cable, and mobile telecom markets, good track record of maintaining solid margins through cost-cutting, and extensive and well-developed copper, cable, fiber, and mobile networks. These strengths are constrained by limited growth prospects in the mature and competitive Danish telecom market, as well as TDC's limited diversification and relatively small customer base. Our anticipation of declining revenues over the next two years also weighs on the business risk profile assessment.

Our assessment of TDC's financial risk profile remains at "intermediate," given the company's solid FOCF generation and adjusted debt to EBITDA of 2.5x-3.0x. The company's financial policy targets a maximum leverage ratio (net debt to EBITDA) of 2.2x on average during the year; after our adjustments this translates into about 2.8x. These strengths are constrained by some ratios that indicate a weaker financial risk profile, specifically, adjusted funds from operations to debt of 25%-30% and FOCF to debt of 10%-15%. Another constraint is TDC's modest DCF.

In our base case we assume:

- Annual GDP growth in Denmark of 1.3% to 1.5% in 2014 and 2015, after flat GDP growth in 2012 and 2013.
- Revenue decreases of 3.5% in 2014 and 1.5% in 2015 because of continued decline in fixed telephony and the effect of regulatory changes.
- Beyond 2015, stable or slightly higher revenues as decline in fixed telephony slows and negative regulatory pressure eases, and if there is growth in the TV, Nordic, and mobile segments.
- Gradual improvement in the adjusted EBITDA margin because we anticipate further reductions of operating expenditure and a gradual decrease in restructuring costs.
- Annual capital expenditures of about Danish krone (DKK) 3.5 billion-DKK4.0 billion.
- Stable dividends of about DKK3 billion annually.

Based on these assumptions, we arrive at the following credit measures:

- An adjusted EBITDA margin of 40%-42% in 2014-2015, after 39.9% in 2013.
- Adjusted debt to EBITDA of about 2.7x-2.8x.
- DCF of about DKK200 million-DKK300 million per year.

## Liquidity

We have reassessed TDC's liquidity to "adequate" from "strong," according to our criteria. This reflects our forecast that liquidity sources will only cover uses at least by 1.2x over the next 12 months, compared with at least 1.5x previously. For our analysis we consider debt and the undrawn portion of committed bank lines maturing over the next six months. This is because we regard TDC as having strong credit characteristics, including good access to capital markets and solid relationships with its core bankers. The short-term rating is 'A-2'.

We estimate TDC's key liquidity sources at about DKK13.1 billion over the next 12 months, comprising:

- Consolidated cash and equivalents of DKK1.2 billion;
- An undrawn committed unsecured revolving credit facility of €500 million (about DKK3.7 billion) due February 2016;
- Two €100 million (about DKK1.5 billion) committed, unsecured bilateral facilities due December 2016 (of which about DKK1.3 billion is currently undrawn); and
- Annual funds from operations of about DKK7 billion over the next two years.

Against these sources, we anticipate liquidity uses of about DKK7 billion during the next 12 months:

- Annual capital spending of about DKK3.7 billion; and
- Annual dividends of about DKK3 billion.

TDC has a €800 million (about DKK6 billion) bond maturing in February 2015, which we expect to be refinanced during 2014, and a €274 million (DKK2 billion) bond that matures in December 2015.

Back-up facilities include a maintenance financial covenant that would be triggered only if the long-term rating were lowered to below 'BBB-'.

## Outlook

The stable outlook reflects our expectation that TDC's revenues and EBITDA will decline only modestly in 2014-2015.

### Upside scenario

We could raise the ratings if we revised our assessment of TDC's business risk profile upward to "strong." This might occur if TDC's revenues stabilized and it maintained its market shares and current profitability. We could also raise the rating if TDC's credit metrics strengthened, notably if adjusted debt to EBITDA were to decrease sustainably to 2.5x or lower.

### Downside scenario

A downgrade is unlikely over the next 24 months, given our current assessment of TDC's business risk profile as "satisfactory" and the company's current financial policy and leverage targets.

## Ratings Score Snapshot

Corporate Credit Rating: BBB/Stable/A-2

Business risk: Satisfactory
- Country risk: Very low
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Intermediate
- Cash flow/Leverage: Intermediate

Anchor: bbb

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

## Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Key Credit Factors For The Telecommunications And Cable Industry, Dec. 12, 2013
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013

## Ratings List

Ratings Affirmed; Outlook Action

| | To | From |
|---|---|---|
| TDC A/S | | |
| Corporate Credit Rating | BBB/Stable/A-2 | BBB/Positive/A-2 |
| Senior Unsecured | BBB | BBB |

**Additional Contact:**
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