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Research Update:

Danish Telecoms Provider TDC Downgraded To 'BBB-/A-3' On Competitive Domestic Market; Outlook Stable

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Overview

- Danish telecommunications provider TDC A/S continues to be exposed to fierce competition in its domestic market, and the anticipated stabilization of its domestic operating results is taking longer than we expected.
- These factors will likely delay the expected reduction in TDC's leverage and ensuing improvement in its financial risk profile.
- We are therefore lowering our ratings on TDC to 'BBB-/A-3' from 'BBB/A-2'.
- The stable outlook on TDC reflects our view that the deteriorating market conditions in Denmark will moderate in the next two years and TDC will gradually halt erosion in its domestic competitive position over the next 18-24 months.

Rating Action

On Nov. 27, 2015, Standard & Poor's Ratings Services lowered its long- and short-term corporate credit ratings on Danish telecommunications services provider TDC A/S to 'BBB-/A-3' from 'BBB/A-2'. The outlook is stable.

At the same time, we lowered our issue ratings on the company's senior unsecured debt to 'BBB-' from 'BBB' and on its junior subordinated debt to 'BB' from 'BB+'.

Rationale

The downgrade primarily follows our expectation that TDC's recovery from the currently intense competition in mobile telephony in Denmark is likely to be more protracted than we had anticipated. In the first nine months of 2015, group domestic EBITDA declined by about 11%. Given gradually steepening drop in TDC's domestic EBITDA each quarter, we now expect stabilization in the group's operating performance in 2017 rather than 2016. In 2016 we anticipate a further 6%-8% fall in domestic EBITDA. Consequently, we think it unlikely that TDC will deleverage to Standard & Poor's-adjusted debt to EBITDA of about 3x in the near term. Rather, we estimate that debt to EBITDA will remain at about 3.4x-3.5x in 2015-2016.

TDC's mobile products continue to face fierce competition in the domestic market, particularly in its business-to-business (B2B) division, but also in

the business-to-consumer (B2C) segment. These developments have recently led to a sharp decrease in average revenues per user (ARPU) and in revenues and EBITDA. In the third quarter, average B2C mobile voice ARPU fell by about 4% and average B2B ARPU plummeted by about 15% year-on-year. Simultaneously, B2C and B2B EBITDA declined by about 8% and about 16%, respectively. Moreover, we currently see few signs of immediate stabilization. The unsuccessful attempt by competitors TeliaSonera AB and Telenor ASA to combine their Danish operations further weighs on prospects for domestic mobile market recovery, in our view. In addition, we observe headwinds in selected other sub-segments, such as broadband. DSL-based products have been adversely affected by regulatory wholesale price cuts earlier this year, and the national regulator is likely to introduce an additional cable-based broadband wholesale product from 2016.

Aside from these considerations, TDC's business risk profile continues to be supported by its position as the leading telecoms provider in Denmark's residential customer segment, its well-invested mobile network, and its ownership of Norwegian cable operator Get. As of June 30 2015, TDC had generally high market shares in fixed-line telephony services (65%), fixed-line broadband Internet (57%), mobile voice services (41%), and pay-TV services through its Internet protocol TV and cable operations (53%), according to company estimates. We also think that TDC's ownership of Get provides it with additional scale, diversification, and growth opportunities in the less competitive Norwegian market. In other view, other positive aspects for TDC's business risk are its ownership of both the leading domestic copper and cable fixed-line networks, as well as its Standard & Poor's adjusted EBITDA margin of about 40%. These strengths are constrained by limited growth prospects and stiff competition in Denmark. Other weaknesses include TDC's limited geographic diversification, a relatively small customer base, and our forecast of declining revenues and EBITDA in Denmark through 2017.

Our assessment of TDC's financial risk profile primarily derives from the company's increased debt burden after the acquisition of Get. We forecast broadly stable leverage for the company in our base case, with debt to EBITDA at 3.4x-3.5x in the next 18 months. We understand that management remains committed to reduce leverage over time, but absent significant dividend cuts, we see limited room for material improvements in the near term because of the current weakness in TDC's domestic business. We view the company's relatively robust cash flow generation as a positive factor, with free operating cash flow (FOCF) to debt, as adjusted by Standard & Poor's, of about 10% and discretionary cash flow (DCF) to debt of about 5% in the 12 months ended Sept. 30, 2015.

In our base case, we assume:

- Reported revenue growth slightly above 4% in 2015, as the consolidation of Get outweighs declines in Denmark, and a revenue decline of 1%-2% in 2016, principally caused by further contraction in B2C and B2B revenues in Denmark, improving to about flat revenues in 2017.
- EBITDA margins, as adjusted by Standard & Poor's, narrowing by about 1

percentage point to about 41% in 2015 and approximately 40% in 2016 and 2017, resulting from significant EBITDA declines in TDC's Danish operations.

- Lower expenses on special items and taxes compared with historical levels.
- Broadly stable capital expenditures of about Danish kronor (DKK) 4.3 billion in 2015 and 2016, then decreasing modestly in 2017.
- Dividend payments, including DKK200 million in coupon payments on TDC's hybrid debt, of DKK1.8 billion–DKK2.0 billion in 2016 and 2017.

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

- Debt to EBITDA, as adjusted by Standard & Poor's, of 3.3x–3.5x at the end of 2015, after 3.9x in 2014, and 3.5x in 2016, and funds from operations (FFO) to debt, as adjusted by Standard & Poor's, of 21%–24% in 2015–2017.
- FOCF to debt, as adjusted by Standard & Poor's, of about 10% in 2015 to 2017, and DCF to debt of 5%–7% in 2015 and 3%–5% in 2016.

Liquidity

The short-term rating is 'A-3'. We assess TDC's liquidity as adequate because we expect that liquidity sources will cover uses at least by 1.2x over the 12 months started Oct. 1, 2015.

As of Oct. 1, 2015, principal liquidity sources over the ensuing 12 months include:

- Cash balances of DKK 954 million.
- An undrawn committed unsecured revolving credit facility of €500 million (about DKK3.7 billion) due September 2020, and availability under other committed lines of about €175 million (about DKK1.3 billion).
- Annual FFO of about DKK7.1 billion–DKK7.3 billion.
- A committed unsecured loan from the European Investment Bank of €100 million (about DKK750 million), which can be drawn until December 2015 and has a three-to-five year maturity schedule.

As of Oct. 1, 2015, principal liquidity uses over the ensuing 12 months include:

- A December 2015 bond maturity of €274 million (about DKK2.05 billion). We note a large upcoming debt maturity of DKK6.0 billion in February 2018.
- Capital expenditures of about DKK4.3 billion.
- Dividend payments of about DKK1.7 billion and coupon payments on TDC's hybrid debt of DKK200 million in 2016.

Outlook

The stable outlook on TDC reflects our view that the deteriorating market conditions in Denmark will moderate in the next two years and TDC will gradually halt erosion in its domestic competitive position over the next

18–24 months. We assume that this, coupled with potential reductions in dividend payments, will enable TDC to maintain debt to EBITDA, as adjusted by Standard & Poor's, at or below 3.5x and FFO to debt sustainably above 20%, with FOCF to debt at about 10%.

Upside scenario

We could consider upgrading TDC if it turns around its domestic operations more rapidly and significantly than we currently expect, enabling it to reduce Standard & Poor's-adjusted debt to EBITDA to less than 3.0x, combined with FOCF to debt sustainably above 10%.

Downside scenario

We could consider a downgrade if TDC's operating performance deteriorates more than we currently expect, causing Standard & Poor's-adjusted debt to EBITDA to rise sustainably above 3.5x, FFO to debt to fall below 20%, or FOCF to debt to weaken to less than 8% over a protracted period.

Ratings Score Snapshot

Corporate Credit Rating: BBB-/Stable/A-3

Business risk: Satisfactory

- Country risk: Very Low
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Significant

- Cash flow/Leverage: Significant

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 ratings analysis: Neutral (no impact)

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Telecommunications And Cable Industry, June 22, 2014

- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Industry Risk, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Assigning Equity Content To Corporate Entity And North American Insurance Holding Company Hybrid Capital Instruments, April 1, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Criteria Clarification On Hybrid Capital Step-Ups, Call Options, And Replacement Provisions, Oct. 22, 2012
- Methodology: Hybrid Capital Issue Features: Update On Dividend Stoppers, Look-Backs, And Pushers, Feb. 10, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Ratings List

Downgraded

	To	From
TDC A/S Corporate Credit Rating	BBB-/Stable/A-3	BBB/Negative/A-2
Senior Unsecured	BBB-	BBB
Junior Subordinated	BB	BB+

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