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Research Update:

DKT Holdings Affirmed At 'B+' On Sale Of Norwegian Unit; Outlook Stable; TDC Debt On CreditWatch

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Overview

- On July 17, 2018, TDC A/S announced its intention to sell its Norwegian business to Telia Company AB for Norwegian krone (NOK) 21 billion in cash (about €2.2 billion).
- Although TDC has yet to specify how it will use the proceeds, we expect the company will allot a sufficient amount toward debt prepayment or network investments, offsetting the smaller footprint and scale resulting from TDC's retreat from Norway.
- We are therefore affirming our 'B+' long-term issuer credit rating on DKT Holdings ApS.
- We are placing on CreditWatch negative our 'BB-' issue rating on TDC's €3.9 billion senior secured term loan, and we are placing on CreditWatch positive our 'B+' issue rating on TDC's €1.0 billion senior unsecured notes.
- The stable outlook reflects our expectation that a stabilization of EBITDA, alongside debt prepayments from the disposal proceeds, will result in pro forma adjusted debt to EBITDA of 7.0x-7.3x and free operating cash flow (FOCF) to debt of 2%-4% in the next 12 months.

Rating Action

On July 19, 2018, S&P Global Ratings affirmed its 'B+' long-term issuer credit ratings on DKT Holdings ApS, the ultimate parent of Danish telecommunications network operator TDC A/S, and its subsidiary DKT Finance ApS. We also affirmed our 'B+/B' long- and short-term issuer credit ratings on TDC A/S. The outlook on all entities is stable.

At the same time, we placed on CreditWatch with negative implications our 'BB-' issue rating on TDC's €3.9 billion senior secured term loan. We placed on CreditWatch with positive implications our 'B+' issue rating on TDC's senior unsecured notes, amounting to about €1.0 billion. In addition, we affirmed our 'B-' issue rating on DKT Finance's €1.4 billion notes. Finally, we withdrew our 'BB' issue rating on TDC's €750 million hybrid bond, since this instrument has been fully repaid.

Rationale

The affirmation points to our expectation that only a moderate amount of the proceeds from the sale of TDC's Norwegian business to Swedish incumbent telecom operator Telia Company AB--for NOK21 billion (about €2.2 billion) in cash--is likely to be paid to shareholders, and that the majority will be used to repay debt or be reinvested in the company's network. This would offset the incrementally negative impact of the company's reduced footprint and smaller revenue base following the disposal, in our view. We forecast that, in 2018, TDC's entire Norwegian business, including the activities of cable operator Get A/S and TDC Norway's business-to-business activities, will generate about Danish krone (DKK) 3.0 billion of revenues and DKK1.3 billion of EBITDA before exceptional items, equivalent to 15% of group revenues and 16% of group EBITDA.

DKT Holdings announced that it would allocate some of the €2.2 billion proceeds for debt repayment, but also mentioned the possibility of investing in its Danish operations. We understand the company will make final decisions closer to the transaction's closing. However, and important in our assessment of the disposal's credit impact, we think the likelihood of significant cash paid to shareholders is limited, based on our interpretation of the existing debt documentation and certain credit-protective terms. If TDC's owners were to pursue maximum distributions, these would have to pass a 4.1x total net leverage restricted payments test for the consolidation perimeter of TDC, and, successively, a 4.5x total net leverage test for the entire group (laid down in the high yield notes indenture). In our calculations, the payment restriction at TDC would require a prepayment of €750 million-€850 million under the €3.9 billion senior secured term loan. The distribution restriction at the parent, DKT Holdings, would trigger additional prepayments of group debt of about €1.0 billion, leaving about €350 million-€450 million for distributions. In this scenario, our projections for adjusted debt to EBITDA, pro forma the sale of the Norwegian operations, would improve to 7.0x-7.3x in 2018 and 2019, compared with our previous assumption of 7.5x-7.7x.

We believe a scenario in which the company decides to use the cash for a combination of debt repayment and capital expenditure (capex) is equally conceivable. In this case, we estimate that pro forma adjusted debt to EBITDA could fall to 6.5x-7.0x in 2018, before increasing to 7.0x-7.5x in 2019. Although we regard FOCF in this scenario as weak for the current rating, we believe investments in the company's networks, in particular in the fixed broadband access network, would strengthen its competitive position and EBITDA growth opportunities over the longer term. This would offset only about break-even FOCF over the period of investments, under our base case, which incorporates our assumption that an increase in capex of more than one-third above our base-case projection for the Danish business (DKK3.0 billion-DKK 3.3 billion in 2018 and 2019) is hardly feasible from a capacity and operational standpoint.

For all other aspects of our view of DKT Holdings' business and financial risk

profiles, please see our report "DKT Holdings ApS Rated 'B+' On Completion Of Leveraged Buyout Of Danish Telecom Operator TDC; Outlook Stable," published May 9, 2018.

In our base case, incorporating the aforementioned scenario with maximum shareholder returns and pro forma the sale of Get, we assume:

- Real GDP growth in Denmark of 1.9% in 2018 and 2019, paired with a relatively low unemployment rate of about 4%. We think these macroeconomic fundamentals are supportive to some extent to the up-selling of broadband and mobile, despite a limited link between business cycles and telecom spending.
- TDC's mobile subscriber market share to remain broadly stable as the company reaps the benefits of its positioning as a quality player, but further modest churn of broadband customers mainly to resellers on TDC's infrastructure. We think TDC's market share in linear TV will remain stable, but expect further decline of this segment due to customer attrition to over-the-top services.
- In 2018 and 2019, the euro to Danish krone exchange rate at 7.44.
- Organic revenue decline in Denmark (excluding the divestment of TDC Hosting in April 2017) of 1.0%-2.0% in 2018 and 0.5%-1.5% in 2019, versus about 2.9% in 2017, mainly driven by lower revenue in the B2B segment, some decline in B2C TV and landline.
- S&P Global Ratings-adjusted EBITDA margins of 43.0%-44.0% in 2018 and 2019, after 42.6% in 2017, with margins being supported mainly by cost-savings and improved profitability of the B2C mobile segment.
- Capex to sales, excluding spectrum, of 18%-20% in 2018 and 17%-19% in 2019, against 21.6% in 2017, gradually declining as the company completes planned network upgrades and investments in other strategic initiatives.
- Modest spectrum payments of up to DKK400 million (about €54 million) in 2018, including for the upcoming auction, and DKK200 million-DKK300 million in 2019.
- About DKK3.2 billion (€425 million) out of about DKK16.5 billion (€2.2 billion) disposal proceeds allocated to one-time shareholder returns, and the remainder to debt repayment.
- A final hybrid coupon payment of DKK195 million in 2018, and moderate shareholder distributions in 2019.

Based on these assumptions, we arrive at the following S&P Global Ratings-adjusted credit measures, pro forma the sale of Get:

- Debt to EBITDA of 7.0x-7.2x in 2018 and 7.1x-7.3x in 2019 (4.8x-5.1x in 2018 and 2019 excluding shareholder loans), compared with 3.2x for TDC in 2017.
- Funds from operations (FFO) to debt of 9.0%-11.0% in 2018 and 6.0%-8.0% in 2019, after 25.4% in 2017.
- FOCF to debt of 3.0%-5.0% in 2018 and 2.0%-4.0% in 2019, compared with

10.7% in 2017.

In the event that the company decides to use the cash for debt repayment and capex, our assumptions are similar except for the following changes:

- Capex to sales, excluding spectrum, of 25%-27% in 2018 and 2019, reflecting larger investments mainly in the company's Danish fixed broadband network.
- Approximately DKK9.5 billion-DKK 10.0 billion (about €1.3 billion) of about DKK16.5 billion (€2.2 billion) disposal proceeds allocated for debt repayment, with the remaining DKK6.5 billion-DKK7.0 billion (about €900 million) remaining on balance sheet to finance future capex and other corporate purposes.

Based on these assumptions for the alternative scenario, we arrive at the following S&P Global Ratings-adjusted credit measures, pro forma the Get sale:

- Debt to EBITDA of 6.7x-6.9x in 2018 and 7.0x-7.2x in 2019 (4.6x-4.8x in 2018 and 4.8x-5.0x in 2019, excluding shareholder loans).
- FOCF to debt of 1%-3% in 2018 and 0%-1% in 2019.

Liquidity

We assess DKT Holdings' liquidity as adequate, since we expect the ratio of liquidity sources to liquidity uses will comfortably exceed 1.2x in the 12 months from April 1, 2018. We think that DKT Holdings' risk management aims to maintain adequate, though not necessarily strong, liquidity. Our calculation of liquidity sources and uses includes a six-month contribution from operations in Norway.

As of April 1, 2018, we estimate that principal liquidity sources over the ensuing 12 months include:

- Cash balance of about DKK1.4 billion.
- Committed revolving credit facilities (RCFs) totaling €600 million (about DKK4.5 billion), of which €500 million at TDC and €100 million at DKT Finance.
- FFO of DKK5.6 billion-DKK5.9 billion.

For the same period, we estimate that principal liquidity uses include:

- Capex of DKK3.6 billion-DKK4.0 billion.
- Repayments of TDC's existing RCF and finance leases of up to DKK0.6 billion.
- Net cash outflows tied to the TDC acquisition of up to DKK1.6 billion.
- Moderate regular shareholder distributions in 2019.

In addition, we project DKT Holdings to fully use the expected disposal proceeds of about DKK16.5 billion for a combination of debt prepayments,

increases in capex, and shareholder remuneration.

The RCFs issued by TDC and DKT Finance stipulate springing maintenance covenants relating to net debt to EBITDA, as per the covenant definition. We forecast comfortable headroom of more than 30% under these covenants in the next 24 months.

Outlook

The stable outlook reflects our expectation that only a modest amount of the disposal proceeds from TDC's Norwegian business will be returned to shareholders, with the vast majority being applied to debt prepayments or for funding a step-up in network investments. Equally, the stable outlook reflects our view that the group's operating performance in Denmark will continue to improve in 2018 and 2019, particularly driven by better pricing in consumer mobile and further cost-savings, contributing to gradually easing revenue decline and stable or modestly growing EBITDA. Excluding a potential step-up in capex, we think this will enable DKT Holdings to maintain adjusted debt to EBITDA, including shareholder loans, of 7.0x-7.3x, and FOCF to debt of 2%-4% in the next 12 months. If a portion of the funds is designated for an increase in capex, we believe DKT Holdings will report adjusted debt to EBITDA of 7.0x-7.2x in 2019, and at least break-even FOCF.

Downside scenario

We could lower the rating if intense competition, a surge in capex, or shareholder distributions caused adjusted debt to EBITDA to increase above 8.5x, and FOCF to debt to weaken below 2% for a prolonged period. If the company uses the sale's proceeds for a material step-up in capex, we could downgrade DKT if the company did not maintain at least break-even FOCF, or if we assessed that the investments did not materially strengthen its competitive position and EBITDA growth prospects.

Upside scenario

We could raise the rating if higher-than-expected EBITDA and FOCF growth, combined with the reduction of external debt from the Norway disposal proceeds, supported a sustained improvement in our adjusted debt to EBITDA to below 5.5x and FOCF to debt of more than 5%.

CreditWatch

We aim to resolve the CreditWatch negative on the senior secured term loan and the CreditWatch positive on the senior unsecured notes upon closing of the sale, which we expect will occur in the fourth quarter of this year.

Upon closing, we would equalize the rating on the €3.9 billion senior secured term loan with that on the €1.0 billion unsecured notes at TDC. This is

because, without the security over the shares in Get, the security package of the term loan would be sufficiently weak for us to consider the debt as effectively unsecured. However, depending on the amount of debt prepayments made with the proceeds, and the type of instruments prepaid, the deleveraging at TDC could be sufficient to result in recovery prospects of more than 70% for both the unsecured notes and the term loan. Therefore, based on the final capital structure, we could either upgrade the €1.0 billion senior unsecured notes by one notch and affirm the rating on the term loan, or lower the rating on the term loan by one notch and affirm the rating on the senior unsecured notes.

Ratings Score Snapshot

Issuer Credit Rating: B+/Stable/--

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

Financial risk: Highly leveraged
- Cash flow/Leverage: Highly leveraged

Anchor: b+

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)

Issue Ratings--Recovery Analysis

We aim to publish an updated recovery analysis upon resolution of the CreditWatch placements.

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017

- Criteria - Corporates - General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria - Corporates - Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Telecommunications And Cable Industry, June 22, 2014
- Criteria - Corporates - General: The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate Entities, April 29, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- DKT Holdings ApS Rated 'B+' On Completion Of Leveraged Buyout Of Danish Telecom Operator TDC; Outlook Stable, May 9, 2018

Ratings List

Ratings Affirmed

DKT Holdings ApS		
DKT Finance ApS		
Issuer Credit Rating	B+/Stable/--	
TDC A/S		
Issuer Credit Rating	B+/Stable/B	
DKT Finance ApS		
Subordinated	B-	
Recovery Rating	6(0%)	
CreditWatch Action		
	To	From

TDC A/S		
Senior Secured	BB-/Watch Neg	BB-
Recovery Rating	2(70%)	2(70%)
Senior Unsecured	B+/Watch Pos	B+
Recovery Rating	3(55%)	3(55%)

Ratings Withdrawn

	To	From
TDC A/S		
Junior Subordinated	NR	BB/Watch Neg

NR--Not rated.

Additional Contact:
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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