

## **FITCH RATES TDC'S TERM LOAN 'BB+(EXP)'/ 'RR1'**

Fitch Ratings-Moscow/London-18 May 2018: Fitch Ratings has assigned TDC A/S's (TDC) EUR3.9 billion term loan B an expected rating of 'BB+(EXP)'. The loan is secured with bank accounts, intra-group receivables, and shares in both TDC and material subsidiaries.

We estimate recoveries for the secured loan at 100%, corresponding to a Recovery Rating of 'RR1'. This implies a three-notch uplift to TDC's Long-Term Issuer Default Rating (IDR) of 'B+', resulting in the 'BB+' rating for the term loan. The final rating is contingent upon the receipt of final documentation conforming materially to the preliminary documentation reviewed.

### **KEY RATING DRIVERS**

**HoldCo/OpCo Debt Assessed Jointly:** Following a change in ownership of TDC, the new owners plan to refinance the acquisition debt initially raised by its parent DKT Holdings ApS (DKT; B+(EXP)/Stable) and its intermediate holding companies (collectively known as HoldCo), as well as existing debt at TDC, the operating entity (OpCo). We expect total OpCo debt to amount to EUR4.9 billion, including the new EUR3.9 billion senior secured term loan B.

We intend to analyse any HoldCo debt together with debt at TDC as we see both the OpCo and HoldCo tied together from a credit perspective. We do not expect to see significant barriers to cash flow being up-streamed from the OpCo to the HoldCo. Any HoldCo debt would be structurally subordinated to both senior secured and unsecured debt at the OpCo.

**Subordination Risk:** TDC has asked the holders of EUR500 million notes due 2022 and GBP425 million notes due 2023 to waive their change of control put option rights. If they waive their put option rights, we expect these notes will become subordinated to the new senior secured debt, which would also include revolving credit (RCF) and capex facilities alongside the term loan. This would reduce the recovery prospects of the 2022 and 2023 bonds if TDC goes into financial distress.

**Spike in Leverage:** Fitch expects the group's funds from operations (FFO) adjusted net leverage to increase to 6.7x at end-2018 from 3.6x at end-2017, following the acquisition. TDC's leverage had previously benefited from 50% equity credit Fitch had assigned to the company's DKK5.6 billion of hybrid instruments. The planned refinancing of these hybrids will remove this equity credit. We believe that the company should be able to reduce leverage below 6.5x within the next 18-24 months with a combination of stable EBITDA generation, lower capex and potentially reduced dividends.

**Leverage Management:** We believe that the company retains substantial flexibility in managing its leverage. We estimate its pre-dividend free cash flow (FCF) margin will remain strong at high single-digits in 2018-2021. The increase in interest expenses on the back of higher debt will be mitigated by lower capex intensity, which we estimate at around 17%-18% in 2018-2021, compared with 20%-22% in 2015-2017. Shareholder remuneration is another means for the new owners of TDC to manage leverage and FCF as they should have more flexibility with the dividend policy.

**Fixed-Line Supportive:** TDC owns both the incumbent copper network and around half of the cable infrastructure in Denmark. This provides the company with a stronger domestic fixed-line position than its European peers. It also supports the company's long-term credit profile given the lack of competing fixed-line infrastructure. Combined with its number-one domestic market

position, TDC is thus able to sustain slightly higher leverage than peers. Competitive pressures are more prevalent in the mobile and business segments.

**Slower EBITDA Declines:** TDC's domestic EBITDA declined 4.6% yoy in 2017 after 12.7% and 10.5% yoy declines in 2016 and 2015, respectively, indicating that the company's strategy to reduce costs and focus on bundled product value and quality-based differentiation in conjunction with price increases is working. We expect that the new shareholders will not dramatically change the company's operating strategy in the short- to medium-term and TDC's EBITDA should continue to benefit from the company's operating cost reduction programme in 2018. Consistently strong performance in Norway should also contribute to improving EBITDA for the group.

**Network Separation Plan:** The new shareholders intend to split the company into two, creating a customer-facing service unit and a wholesale network company. The latter should become a utility-like regulated wholesale telecom operator generating stable long-term returns. We estimate these changes are likely to take a few years. We have not incorporated these long-term changes into our ratings and will treat such a development as event risk, due to a large number of uncertainties including regulation, the terms of any network separation and impact on TDC's capital structure

## DERIVATION SUMMARY

TDC's ratings reflect the company's leading position within the Danish telecoms market. The company has strong in-market scale and share that spans both fixed and mobile segments. Ownership of both cable and copper-based local access network infrastructure reduces the company's operating risk profile relative to domestic European incumbent peers, which typically face infrastructure-based competition from cable network operators.

TDC is rated lower than other peer incumbents such as Royal KPN N.V (BBB/Stable) due to notably higher leverage, which puts it more in line with cable operators with similarly high leverage such as VodafoneZiggo Group B.V. (B+/Stable), Unitymedia GmbH (B+/RWP), Telenet Group Holding N.V. (BB-/Stable) and Virgin Media Inc. (BB-/Stable). TDC's incumbent status, leading positions in both fixed and mobile markets, and unique infrastructure ownership justify higher leverage thresholds than cable peers.

## KEY ASSUMPTIONS

Fitch's Key Assumptions within our Rating Case for the Issuer

- Stabilisation of revenue in 2018 and a flat trend thereafter
- Broadly stable EBITDA margin at around 40%-41% in 2018-2021
- Capex at around 17% of revenue in 2018-2021 (including spectrum)
- Conservative dividend policy to support initial deleveraging
- No M&A

## KEY RECOVERY RATING ASSUMPTIONS

- The recovery analysis assumes that the company would be considered a going concern in bankruptcy and that it would be reorganised rather than liquidated
- A 10% administrative claim
- Our going-concern EBITDA estimate of DKK6.6 billion reflects Fitch's view of a sustainable, post-reorganisation EBITDA level upon which we base the valuation of the company
- Our going-concern EBITDA estimate is 20% below LTM 2017 EBITDA, assuming likely operating challenges at the time of distress
- An enterprise value (EV) multiple of 6x is used to calculate a post-reorganisation valuation and reflects a conservative mid-cycle multiple

- We estimate the total amount of debt for claims at EUR6.8 billion, which includes debt instruments at OpCo and HoldCo level as well as drawings on available credit facilities
- We incorporate EUR4.25 billion of prior-ranking debt (term loan B of EUR3.9 billion, EUR300 million of RCF and 50% of EUR200 million capex facility) and EUR1 billion of remaining senior unsecured debt at OpCo. Fitch calculates the recovery prospects for the senior secured debt at TDC at 'RR1'/100% which implies a three-notch uplift to the IDR to result in the 'BB+' rating for the term loan.

## RATING SENSITIVITIES

Developments that May, Individually or Collectively, Lead to Positive Rating Action

- Expectation that FFO adjusted net leverage will fall below 5.7x on a sustained basis
- Strong and stable FCF generation, reflecting a stable competitive and regulatory environment

Developments that May, Individually or Collectively, Lead to Negative Rating Action

- FFO adjusted net leverage above 6.5x on a sustained basis
- Further declines in the Danish business resulting in FCF margins in mid-to low-single digits

## LIQUIDITY

Comfortable Liquidity: We expect the OpCo and HoldCo to have comfortable liquidity positions upon refinancing, which will be supported by EUR600 million of credit facilities. We expect this to comprise EUR500m of RCF and capex facilities at the OpCo, and a EUR100m RCF at the HoldCo. The maturity profile is yet to be established, but given the major refinancing of the existing instruments, we expect the first large debt pay-out to be only in three to five years. The company's liquidity profile is also supported by strong pre-dividend FCF generation.

Contact:

Principal Analyst

Rachel Chin

Associate Director

+44 20 3530 1629

Supervisory Analyst

Slava Bunkov

Director

+7 495 956 9931

Fitch Ratings CIS Ltd

26 Valovaya Street

Moscow 115054

Committee Chairperson

Damien Chew, CFA

Senior Director

+44 20 3530 1424

Date of Relevant Rating Committee: 4 May 2018

Media Relations: Adrian Simpson, London, Tel: +44 203 530 1010, Email: [adrian.simpson@fitchratings.com](mailto:adrian.simpson@fitchratings.com).

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com). For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

#### Applicable Criteria

Corporate Hybrids Treatment and Notching Criteria (pub. 27 Mar 2018)

<https://www.fitchratings.com/site/re/10024296>

Corporate Rating Criteria (pub. 23 Mar 2018)

<https://www.fitchratings.com/site/re/10023785>

Corporates Notching and Recovery Ratings Criteria (pub. 23 Mar 2018)

<https://www.fitchratings.com/site/re/10024585>

Country-Specific Treatment of Recovery Ratings Criteria (pub. 16 Apr 2018)

<https://www.fitchratings.com/site/re/10026835>

Sector Navigators (pub. 23 Mar 2018)

<https://www.fitchratings.com/site/re/10023790>

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