FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms PPF Telecom Group at 'BBB-'; Outlook Stable

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Fitch Ratings - Frankfurt am Main - 26 Oct 2021: Fitch Ratings has affirmed PPF Telecom Group B.V's (PPF TG) Long-Term Issuer Default Rating (IDR) and senior unsecured rating at 'BBB-'. The Outlook on the IDR is Stable.

The ratings of PPF TG reflect the strong position of its incumbent telecoms assets in the Czech Republic (CR) and its leading mobile position in five central and eastern European (CEE) markets. The company retains significant financial flexibility to manage its leverage profile as a result of sufficient cash flow generation and dividend flexibility. This flexibility, together with PPF TG's operating profile and management's willingness to adjust dividends, if needed, to manage and sustain the company's leverage profile, has been essential to the company's investment-grade rating

Fitch has reduced PPF TG's funds from operations (FFO) net leverage thresholds for the rating by 0.2x. The reduction follows the agreement by the company to sell a 30% stake in its network infrastructure unit CETIN Group N.V (BBB / Stable) and reflects our assessment of its weaker operating profile, as a result of a reduction in the holding. Despite this, we expect that PPF TG's FFO net leverage will trend comfortably within the new rating thresholds.

KEY RATING DRIVERS

Strong Czech Operations: PPF TG owns the incumbent Czech telecoms infrastructure, which includes the local-access network and the ability to deploy convergent product propositions. The company's Czech operations were 48% of total EBITDA (excluding the impact from IFRS16) in 2020 with the remainder from its other CEE assets. PPF TG has a solid position in the mobile market, with a Fitch-estimated service revenue market share of about 35% (2020). The mobile market is slightly growing, supported by increasing consumer spending and macro-economic factors.

Czech Broadband Market Competitive: PPF TG's retail broadband revenue market share in the CR is lower than its mobile market share at an estimated 25% (2020) but broadly stable. This reflects a more competitive market structure as a result of alternative WiFi, and cable/fibre local access network infrastructures. The deployment of fibre by T-Mobile CR in partnership CETIN Group may create medium-term pressures on PPF TG's wholesale revenue in the CR. Investment plans to increase PPF TG's fibre network's depth and breadth should support the company's market position and offset some of the impact through higher average revenue per user (ARPU).

Structural Separation, Increased Focus: PPF TG has restructured its operations into three main business lines: two customer-facing, commercial retail units namely O2 CR and Telenor CEE, and a wholesale, infrastructure arm housing network infrastructure and mobile towers held by CETIN Group N.V. The restructuring brings all of PPF Group's telecoms holding under PPF TG. The move aims to simplify its corporate structure, improve execution along differing management competencies and increase transparency of the underlying asset value.

Well-Positioned CEE Mobile Assets: PPF TG's mobile CEE operations are in Hungary, Bulgaria and Slovakia. The assets have number one or two market positions and operate in a three-operator mobile market structure that should support service revenue growth through data monetisation and pre- to post-paid migration. A lack of fixed-network ownership may create disadvantages compared with a convergent network strategy, but we see the risks as manageable through partnerships and mobile network infrastructure-sharing.

Infrastructure Sale Weakens Profile: PPF TG has agreed to sell a 30% stake in CETIN Group to Singapore- based GIC, an infrastructure investor. The sale reduces PPF TG's exposure to stable and visible cashflows that are generated by its infrastructure unit, which we deem weakens PPF TG's operating profile. This has led to a 0.2x reduction in our FFO net leverage thresholds for the rating, which now range between 3.1x to 3.6x.

Retained Financial Flexibility: We expect PPF TG will use part of the proceeds from the stake sale in CETIN Group to reduce gross financial debt. Our revised forecasts indicate that FFO net leverage will increase to 3.6x by end-2021 - assuming the deal closes in 2021 - from 3.2x at end-2020 before reducing to 3.1x by 2023. The increase is primarily driven by the acquisition of minorities at O2 CR. PPF TG manages its leverage profile through a flexible dividend policy, a net debt-to-EBITDA target of 2.8x-3.2x (excluding IFRS16) and strong cashflow generation.

FCF Margin Underpins Deleveraging Capacity: Our base case forecasts estimate that PPF TG has an underlying pre-dividend free cash flow (FCF) margin, excluding spectrum costs, of 14% to 16% over the next three years. This provides an organic deleveraging capacity of about 0.2x (FFO net leverage) a year. PPF TG's intention and ability to adjust dividend payments to maintain leverage within the thresholds of the rating is an essential driver of its investment-grade rating.

Domestic Downside Risks: A number of factors in the Czech market could pose downside risks to Fitch's base-case FCF forecasts for PPF TG. These include the entry of a fourth mobile operator, regulatory remedies from the EU due to network-sharing, a more rapid deployment of fibre and higher-than-expected impact from the deployment of fibre by T-Mobile CZ. Dividend flexibility should help the company manage the financial impact if such risks materialise.

FX Risks to Leverage: PPF TG had about 90% of its total debt denominated in euros and 25% of its EBITDA (assuming the peg between the euro and Bulgarian lev is maintained) in euros. This creates foreign-exchange (FX) mismatch to leverage. The stability or appreciation of the Czech koruna to the euro over the past five years, however, reduces the real impact of the mismatch, given 49% of total EBITDA is denominated in the local currency.

Consolidated Rating, No Subordination: PPF TG's ratings are based on a fully consolidated business scope with no structural subordination as a result of existing subsidiary-level debt. The consolidated basis of the rating reflects the ownership structure and the existence of one-way cross-default obligations for PPF TG on behalf of its operating subsidiaries. These factors, on balance, outweigh subsidiary-level covenants, financial policies and minority holdings that could restrict dividend upstreaming in extreme situations.

Standalone Rating Profile: We rate PPF TG on a standalone basis with no influence from other parts of the PPF Group. The standalone profile reflects a lack of legal, financial and operational ties between PPF TG and other parts of the group. PPF Group has four main business divisions covering telecommunications, media, banking and financial services, and real estate. All four units are independently managed and financed.

DERIVATION SUMMARY

The consolidated operating and financial profiles of PPF TG benchmark well against its peer group of incumbent European operators such as Royal KPN N.V. (BBB/Stable) and BT Group plc (BBB/Stable). PPF TG's lower rating reflects a financial policy that is likely to sustain higher leverage and reduced ownership of domestic local-access infrastructure.

PPF TG's geographic diversification benefits are tempered by lower cash flow, the complexity of group structure, some FX mismatch to leverage and three to four local-access network infrastructures for broadband in the CR compared with two in most other European markets. Higher-rated peers such as Vodafone Group Plc (BBB/Stable) and Orange S.A. (BBB+/Stable) have greater diversification, scale or manage leverage at lower levels.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Revenue of around EUR3.2 billion in 2021, growing by around 1% per year over the next three years

- EBITDA margin of 41% in 2021, gradually increasing to 44% over the next three years

- Cash tax of EUR143 million in 2021, with a broadly stable effective tax rate over the next three years

- Capex (excluding spectrum costs) at 16% to 18% of revenue between 2021 and 2024

- Dividend payment of EUR100 million in 2021 and gradually increasing to EUR300 million by 2024

- Net acquisition and disposal proceeds of about EUR0.7 billion to be used for shareholder remuneration and reducing gross financial debt (assumes closing of CETIN Group minority sale in 2021 but this could transpire in early 2022)

- Net debt-to-EBITDA maintained at the low-to-middle range of the company's target of 2.8x-3.2x

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Sustained growth in FCF leading to improved FCF margins and organic deleveraging capacity

- FFO net leverage falling below 3.1x on a sustained basis

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- A material and sustained decline in EBITDA or FCF driven by competitive or technology-driven pressure in core business segments

- A change in the financial policy that results in reduced financial flexibility, higher long-term leverage targets, or contractual debt obligations to other parts of the PPF Group. Any substantive increase in PPF Group's dependency on PPF TG's dividends could put pressure on the rating

- FFO net leverage trending above 3.6x on a sustained basis

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Comfortable Liquidity: At end-1H21, PPF TG had cash and cash equivalents of EUR705 million. The group has also an undrawn committed credit facility of EUR625 million that matures in 2026 and an undrawn revolving credit facility (RCF) of EUR200 million at CETIN Group. Combined with internal cashflow generation, this is sufficient to cover EUR625 million of Eurobonds maturing in December 2021. PPF TG has no material debt maturities in 2022.

ISSUER PROFILE

PPF TG is a medium-sized telecoms operator within the CEE region with a consolidated EBITDA of EUR1.4 billion. The company is active in Bulgaria, Czechia, Hungary, Montenegro, Serbia and Slovakia, providing mobile, fixed-line, data and internet television services to end users, and telco infrastructure services to telecom operators.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
PPF Telecom Group B.V.	LT IDR	BBB- Rating Outlook Stable	Affirmed	BBB- Rating Outlook Stable
• senior unsecured	LT	BBB-	Affirmed	BBB-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Parent and Subsidiary Linkage Rating Criteria (pub. 26 Aug 2020)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 15 Oct 2021) (including rating assumption sensitivity)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 15 Oct 2021)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

PPF Telecom Group B.V.	EU Issued, UK Endorsed

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