FitchRatings

05 Mar 2020 | Affirmation

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

Fitch Ratings-Frankfurt am Main-05 March 2020:

Fitch Ratings has affirmed PPF Telecom Group B.V.'s (PPF TG, formerly PPF Arena 1) Long-Term Issuer Default Rating (IDR) and senior unsecured rating at 'BBB-'. The Outlook on the IDR is Stable.

The rating of PPF TG reflects the strong position of its incumbent telecoms assets in the Czech Republic (CR) and its leading mobile position in three central and eastern European (CEE) markets. Funds from operations (FFO)-adjusted net leverage is likely to be just within our negative sensitivity of 4.0x for the next 12 to 24 months before potential deleveraging. This leaves limited headroom within the rating to absorb unforeseen financial and operational pressures.

PPF TG, however, retains significant financial flexibility to manage its leverage profile as a result of sufficient cash flow generation and dividend flexibility. This flexibility, together with the 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.

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. Its Czech operations accounted for 49% of total EBITDA (excluding the impact from IFRS16) in 2019 with the remainder from its CEE assets. PPF TG has a solid position in the mobile market with a Fitch-estimated service revenue market share of about 36% at end-2019. The mobile market is slightly growing, supported by increasing consumer spending and macroeconomic factors.

Czech Broadband Market Competitive: PPF TG's retail broadband revenue market share in the CR is lower than the company's mobile market share at a Fitch-estimated 31% (2019) 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 adds to the duplication of infrastructure with possible medium-term pressures to wholesale revenues in the CR. Investment plans to increase the depth and breadth of its fibre network should support PPF TG's market position.

Structural Separation, Increased Focus: PPF TG separated its fixed and mobile network

infrastructure and retail operations into two companies in the CR. CETIN a.s. (BBB/Stable) focuses on infrastructure wholesale, while O2 CR provides retail services. The separation aims to increase operational focus, efficiency and scale in network investments while reducing regulatory overheads. Mobile network-sharing with T-Mobile, which includes radio access equipment, improves the company's cost structure compared with other European mobile operators' and is likely to provide an efficient platform for deploying 5G network services over the next three-to-four years.

Well-Positioned CEE Mobile Assets: PPF TG's CEE assets in Hungary, Bulgaria, Serbia and Montenegro acquired in 2018 add to international mobile operations in Slovakia. The acquired 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. Risks to the emergence of fourth mobile operator in Hungary are diminishing. While a lack of fixed network ownership may create disadvantages compared with a convergent network strategy, we see the risks as manageable through partnerships and mobile network infrastructure-sharing.

Limited Headroom but Proactively Managed: We expect PPF TG's FFO-adjusted net leverage to increase to about 4.0x over the next two-to-three years from 3.5x at end-2019. The increase is primarily driven by a combination of higher capex, spectrum costs and a higher dividend payment rate in 2020, assuming the company manages its leverage at the higher end of its financial policy. This will leave the PPF TG with limited headroom in the rating for managing operational pressures in the short-term and exploiting new investment opportunities.

Retained Financial Flexibility: PPF TG manages its leverage profile through a flexible dividend policy and with a targeted net debt-to-EBITDA of 2.8x-3.2x, excluding the impact of IFRS16. This corresponds to 3.8x-4.2x on a FFO-adjusted net leverage basis. The company's underlying pre-dividend free cash flow (FCF) margin, excluding spectrum costs, is expected to be around 14% over the next three years based according to our forecasts. This provides an organic deleveraging capacity of up to 0.3x-0.4x (FFO-adjusted net leverage) a year, if no dividends are distributed and assuming our base case EBITDA growth. PPF TG's ability to adjust dividend payments to maintain leverage within the thresholds of the rating is an essential driver of the investment-grade rating.

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

Potential FX Risks to Leverage: At end-2019, 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) denominated in euros. This creates 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. PPF TG is able to hedge the cash flows it receives in foreign currencies to largely mitigate fluctuations in relation to the debt servicing of its current loan. However, a lack of visibility on medium- to long-term FX fluctuations raises risks to leverage.

Consolidated Rating, Minor Subordination: PPF TG's rating assumes 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 one-way cross default obligations for PPF TG on behalf of its operating subsidiaries in CR. These factors, on balance, underpin our consolidated assessment as opposed to an approach that deconsolidates the Czech operating companies due to subsidiary-level covenants and financial policies that could restrict dividend upstreaming in extreme situations. The lack of structural subordination of parent-level debt reflects the low quantum of operating subsidiary-level debt.

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 three main business divisions covering telecommunications, banking and financial services, and real estate. All three units are independently managed and financed.

Derivation Summary

The consolidated operating and financial profiles of PPF TG benchmark well with 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 leverage at higher levels. Its operating profile is rated stronger than predominantly mobile-only operators such as Sunrise Communications Holdings S.A. (BB+/Stable) and P4 S.p.z.o.o (BB/Stable) and benefits from a greater leverage capacity.

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 and / 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 2020, growing by around 1% per year over the next three years.

- EBITDA margin (excluding IFRS16 impact) of 40.5% in 2020, gradually increasing to 42% over the next three years.

- Effective cash tax rate of about 18% in 2020 remaining broadly stable thereafter.

- Capex-to-revenue ratio (excluding spectrum costs) of 14% to 15% between 2020 and 2023.

- Dividend payment of EUR650 million in 2020, declining to around EUR400 million in 2021 and remaining broadly stable between 2022 and 2023.

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

- Adjusted debt calculated using a weighted average operating lease multiple of 7.6x, reflecting a multiple of 8x for liabilities in CR and Slovakia and 7x for liabilities in Bulgaria, Hungary, and Serbia and Montenegro.

RATING SENSITIVITIES

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

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

- FFO-adjusted net leverage falling below 3.5x on a sustained basis

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

- 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 would put pressure on the rating

- FFO-adjusted net leverage trending above 4.0x on a sustained basis

Liquidity and Debt Structure

Comfortable Liquidity: PPF TG had cash and cash equivalents of EUR795 million and an undrawn five-year revolving credit facility of EUR200 million at 31 December 2019. PPF TG has no material debt maturities in 2020 and pre-dividend FCF provides a further source of liquidity if needed. Upcoming maturities in PPF TG's subsidiaries include O2 Czech Republic's EUR276 million in term loans maturing 2020 and CETIN's EUR625 million bond maturing in 2021.

Summary of Financial Adjustments

For 2019, readily available cash is adjusted to include EUR12 million of cash collateral for derivative instruments. Debt is adjusted to include net derivative liabilities of EUR52 million.

Fitch has not adjusted for receivables factoring in 2019 of approximately EUR60 million as the impact to leverage metrics is immaterial.

ESG Considerations

ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

PPF Telecom Group B.V.; Long Term Issuer Default Rating; Affirmed; BBB-; RO:Sta
----senior unsecured; Long Term Rating; Affirmed; BBB-
----senior secured; Long Term Rating; Affirmed; BBB-

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Applicable Criteria

Corporate Rating Criteria (pub. 19 Feb 2019)
Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019)
Parent and Subsidiary Rating Linkage (pub. 27 Sep 2019)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
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