FitchRatings

25 OCT 2022

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

Fitch Ratings - Warsaw - 25 Oct 2022: 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.

PPF TG's ratings reflect its strong portfolio of telecoms assets and retained financial flexibility. PPF TG operates the incumbent telecoms network in the Czech Republic and holds a leading position in five central and eastern European (CEE) mobile markets. The combination of strong free cash flow (FCF) generation and a flexible dividend policy provide discretionary capacity to manage the company's leverage profile. These factors, along with a historical record of adjusting dividends if required, have been essential to the company's investment-grade rating.

Key Rating Drivers

Strong Domestic 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 made up 49% of total EBITDA (based on the company's definition) in 2021 with the remainder from its other CEE assets. PPF TG has a solid position in the Czech mobile market, with a Fitch-estimated service revenue market share of about 35% (2021). The mobile market is slightly growing, supported by increasing consumer spending and macro-economic factors.

Czech Broadband Market Competitive: PPF TG has an estimated retail broadband subscriber market share in the Czech Republic of 27% (2021). The deployment of fibre to the curb and home is allowing subscriber growth. However, the market is structurally competitive due to a mix of alternative WiFi, cable and fibre local access network infrastructures. The deployment of fibre by T-Mobile CR in partnership with CETIN Group may create medium-term pressures on PPF TG's wholesale revenue in the Czech Republic. 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.

Well-positioned CEE Mobile Assets: PPF TG's mobile CEE operations are in Hungary, Bulgaria, Serbia 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 view the risks as manageable through partnerships and mobile network infrastructure-sharing.

Structural Separation, Increased Focus: PPF TG has structured its operations into three main business lines: two customer-facing, commercial retail units, namely O2 in Czech Republic and Slovakia and Yettel in 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. However, the sale of a 30% stake in the company's infrastructure assets does weaken the operating profile and is reflected in the leverage thresholds for the rating.

Retained Financial Flexibility: We expect funds from operations (FFO) net leverage to trend comfortably within the 3.1x to 3.6x thresholds for the rating over the rating horizon. Our base case forecasts estimate that PPF TG's pre-dividend FCF margin, excluding spectrum costs, will range between 11%-13% over the next four years. This provides good flexibility to manage leverage in line with the company's net debt-to-EBITDA target of 2.8x-3.2x (excluding IFRS16). Based on our dividend projections in our base case forecasts, we believe PPF TG will retain organic deleveraging capacity of about 0.1x-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 (limited impact in the short to medium term given potential uncertainties on network deployment and viability of business case), a more rapid deployment of fibre and higher-than-expected impact from the deployment of fibre by T-Mobile CR. Dividend flexibility should help the company manage the financial impact if these risks materialise.

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

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 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 with no legal guarantees or cross default obligations from PPF TG to other parts of the group.

Derivation Summary

PPF TG's consolidated operating and financial profiles 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 Czech Republic 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 its Rating Case for the Issuer

- Revenue of around EUR3.4 billion in 2022, growing by 1%-2% per year over the next three years

- Fitch-defined EBITDA margin of 42% in 2022, gradually increasing to 44% over the next three years

- Cash tax of EUR169 million in 2022, with a broadly stable effective tax rate over the next three years

- Capex (excluding spectrum costs) at 17% to 18% of revenue between 2022 and 2025

- Dividend payment of EUR91 million in 2022 (excluding any one-off distributions) and gradually increasing to EUR550 million by 2025

- Company-defined 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 (about 2.8x Fitch defined net debt to EBITDA) 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 (about 3.3x Fitch defined net debt to EBITDA) 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-FY21, PPF TG had cash and cash equivalents of EUR628 million and an undrawn committed revolving facility of EUR200 million that matures in 2026 and an undrawn revolving credit facility of EUR200 million at CETIN Group. Combined with internal cash-flow generation, this provides sufficient cover for any near-term cash requirements. We note EUR196 million bonds fall due in December 2023.

Issuer Profile

PPF TG is a medium-sized telecoms operator within the CEE region with a consolidated EBITDA of EUR1.5 billion. The company is active in Bulgaria, Czech Republic, Hungary, 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

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Rating Actions

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

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

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

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

Parent and Subsidiary Linkage Rating Criteria (pub.01 Dec 2021)

Sector Navigators: Addendum to the Corporate Rating Criteria (pub.15 Jul 2022)

Applicable Models

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.0.3 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

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

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