

RATING ACTION COMMENTARY

Fitch Places PPF Telecom Group on Rating Watch Positive

Mon 21 Oct, 2024 - 7:30 AM ET

Fitch Ratings - Warsaw - 21 Oct 2024: Fitch Ratings has placed PPF Telecom Group B.V.'s (PPF TG) Long-Term Issuer Default Ratings (IDR) and senior unsecured ratings of 'BBB-' on Rating Watch Positive (RWP). A full list of rating actions is detailed below.

The RWP follows the regulatory approval of the transaction between e& and PPF Group, in which e& will acquire a controlling stake in PPF TG's assets in Bulgaria, Hungary, Serbia, and Slovakia. Fitch expects PPF TG to benefit from a one-notch uplift to its 'bbb-' Standalone Credit Profile (SCP) upon completion of the transaction because we assess that e&, which has a stronger credit profile than PPF Group, will have sufficient legal incentives to support PPF TG.

PPF TG's 'bbb-' SCP reflects our view that post-completion, the company's operating profile will weaken, as existing Czech assets will be transferred out of the company. We expect this will be offset by a more conservative financial policy, enabling the company to retain its existing SCP. We also expect PPF TG to retain discretion to manage its capital structure through dividend flexibility.

The RWP would be resolved upon completion of the transaction, which is expected in the second half of October 2024. The completion, based on our current understanding of the structure of the transaction, the implementation of commitments made to the EU competition authorities as a condition of their approval of the deal, and management's intended financial policy is likely to result in a 'BBB' IDR.

KEY RATING DRIVERS

Strong Market Position, Mainly Mobile: After completion of the transaction and transfer of the Czech assets, PPF TG's operating profile will mainly comprise mobile network operations in Hungary, Bulgaria, Serbia and Slovakia. PPF TG has strong and sustainable positions in these markets, occupying mostly number one or two market positions. The assets also operate in three-operator mobile markets that should support rational competitive dynamics and potential service revenue growth through data

monetisation, price increases, effective churn management and pre- to post-paid migration.

PPF TG's lack of fixed network ownership may create disadvantages compared with a converged network operator, but we view the risks as manageable through partnerships and mobile network infrastructure-sharing. Its current fixed market shares in each country are in the low single digits and we expect these to improve, but remain relatively low over the coming years.

Change in Operating Profile: PPF TG's existing assets in the Czech Republic, which include O2 Czech Republic a.s. (O2 CZ) and telecommunications infrastructure provider CETIN a.s., are not part of the transaction and have been transferred out of PPF TG. PPF Group will retain its 100% indirect share in O2 CZ and its indirect share in CETIN. The transfer of the Czech assets will weaken PPF TG's operating profile, which will become mainly mobile-based. The Czech assets span both mobile and fixed networks, and add to asset and geographic diversification in the pre-transaction structure.

More-Conservative Financial Structure: Post-completion, we expect the PPF TG's weaker operating profile to be offset by a more conservative financial policy and capital structure. PPF Group and e& indicate that they will manage net debt at 2x of company-defined EBITDA, which is commensurate with a 'bbb-' SCP, given the weaker business profile after the transaction. The latter is also reflected in tightened rating thresholds.

Leverage Target to be Prioritised: Our base case assumes PPF TG will prioritise its leverage target over dividends to keep leverage at the upper end of the target rating band, which results in minimal rating headroom. The rating could come under pressure if PPF TG does not reduce dividend payments, if needed, to keep to within this leverage band.

One-Notch Rating Uplift: Post-completion, Fitch expects to rate PPF TG using a bottom-up + 1 approach under our Parent Subsidiary Linkage Rating Criteria (PSL). The uplift reflects our view of medium legal ties, while both operational and strategic incentives for e& to support PPF TG are deemed to be low under the 'stronger parent' path. To win approval from EU authorities, e& agreed to a prohibition on e& providing financing to PPF TG's activities in the EU, subject to certain exceptions. However, we believe a carve-out allowing e& to provide "emergency funding" is consistent with the one-notch uplift suggested under the PSL.

'Medium' Legal Support Incentive: The legal incentive assessment reflects that PPF TG would be considered a principal subsidiary under e&'s euro medium-term note (EMTN) programme documentation, as it would contribute more than 10% of EBIT and more

than 10% of the gross assets on a fully consolidated basis. This implies PPF TG would be subject to cross-default clause under the EMTN documentation.

While the debt issued under the EMTN programme is likely to be long-dated, the definition of the principal subsidiary is related to the contribution to EBIT and assets, which can change if e& acquires other assets or grows more strongly in other regions. Importantly, the EMTN provisions do not indicate the existence of any guarantee. This leads to our assessment of medium legal incentive as opposed to high legal incentive.

Manageable FX Risk: We assume that post-completion, PPF TG's capital structure will comprise of euro denominated debt only over the forecast period. We forecast the share of EBITDA from Hungary to rise to 31% in FY28 in our base case, from 29% in FY24, resulting in FX mismatches as its debt is in euros and cash flows in forint.

Cash flows from other markets are not likely to pose significant FX risks, given Slovakia's functional currency is the euro, while the Bulgarian and Serbian currencies are either pegged to euro officially or have a long record of stability against the euro. In our view, a degree of FX volatility is manageable, while significantly higher-than-expected volatility could impact the rating and leverage capacity.

DERIVATION SUMMARY

After the transaction's completion, the transfer of the Czech assets out of PPF TG will weaken its operating profile, which will become mobile-centric. Despite some geographical diversification, the company will operate in weaker operating environments, with about 85% of EBITDA generated from countries rated 'BBB' or below. We expect FX risk to marginally increase as Hungary's share of EBITDA increases over the next three to four years.

In our view, PPF TG's predominantly mobile-only profile will compare well to Telefonica Deutschland Holding AG (TEF DE, BBB/Stable), which operates in the German market. TEF DE's rating is supported by larger scale, lower leverage, a strong operating environment and no FX risk. PPF TG has a similarly strong market position in the countries it operates in, with the rating tolerating a degree of FX risk as result of this and relatively greater diversification. PPF also commands higher margins than TEF DE's rating.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer (post the e& transaction):

- Revenue of around EUR2.1 billion in 2024 on pro-forma basis, equivalent to 6.0% yoy growth, mainly driven by price increases across the countries of operation. Revenue to increase by about 4% a year in 2025-2028
- Fitch-defined EBITDA margin of around 38% in 2024, gradually increasing to 42% by 2028
- Capex (including spectrum payments) of 18% and 21% of revenue in 2024 and 2025, respectively; declining to 10% by 2028
- Tax rate at 18% of EBITDA throughout the forecast period
- Working capital outflow of -0.5% of revenue throughout the forecast period
- Dividend payments of around EUR300 million in 2024 and gradually increasing to EUR580 million by 2028

RATING SENSITIVITIES

The following sensitivities are based on PPF TG's current operating and financial profiles, prior to the e& transaction closing. These will remain in place if the transaction does not materialise and the current financial profile remains in place, under which we would remove the rating from RWP.

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
- Fitch-defined net debt falling below 2.8x 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 businesses
- 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 PPF Group. A substantial increase in PPF Group's dependence on PPF TG's dividends could put pressure on the ratings

- Fitch-defined net debt trending above 3.3x EBITDA on a sustained basis

On completion of the transaction with e& in line with our current understanding of the structure of the transaction, the implementation of commitments made to the EU competition authorities as a condition of their approval of the deal, and management's intended financial policy, we would upgrade the entity to 'BBB', reflecting a one-notch uplift under the PSL. The following rating sensitivities reflect the expected PPF TG's SCP operating and financial profiles post-completion of the transaction.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Fitch-defined net debt falling below 1.8x EBITDA on a sustained basis
- (CFO - capex) / debt sustained above 14%
- Sustained growth in FCF leading to improved FCF margins and organic deleveraging capacity

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- Fitch-defined net debt trending above 2.3x EBITDA on a sustained basis
- A material and sustained decline in EBITDA or FCF driven by competitive or technology-driven pressure in core businesses
- (CFO - capex) / debt sustained below 12%

LIQUIDITY AND DEBT STRUCTURE

Comfortable Liquidity: PPF TG (including Czechia) had cash and cash equivalents of EUR756 million at end-1H24. EUR197 million under the EUR200 million revolving credit facility (RCF) at CETIN Group, maturing in 2026, was used in December 2023 to repay the CZK4.9 billion (about EUR196 million) of senior unsecured bonds at CETIN a.s. CETIN Group with its debt facilities will be moved outside of PPF TG at the transaction's completion. We expect the upcoming January 2025 bond maturities to be covered with the available liquidity sources, including new RCF.

ISSUER PROFILE

PPF TG is a medium-sized telecom operator within the CEE region with a consolidated Fitch-defined EBITDA of about EUR1.6 billion, including Czechia (EUR815 million

excluding Czechia).

SUMMARY OF FINANCIAL ADJUSTMENTS

Fitch adjusts Fitch-defined EBITDA and working capital change for amortisation of costs to obtain contracts. This is to align the approach across the portfolio. The adjustment has a negative impact on EBITDA and positive on the working capital change.

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.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

[Click here](#) to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit <https://www.fitchratings.com/topics/esg/products#esg-relevance-scores>.

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕	PRIOR ↕
PPF Telecom Group B.V.	LT IDR BBB- Rating Watch Positive	BBB- Rating Outlook Stable
	Rating Watch On	

senior unsecured

LT BBB- Rating Watch Positive

BBB-

Rating Watch On

[VIEW ADDITIONAL RATING DETAILS](#)**FITCH RATINGS ANALYSTS****Rafal Kaminski**

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APPLICABLE CRITERIA

[Parent and Subsidiary Linkage Rating Criteria \(pub. 16 Jun 2023\)](#)

[Corporate Rating Criteria \(pub. 03 Nov 2023\) \(including rating assumption sensitivity\)](#)

[Sector Navigators – Addendum to the Corporate Rating Criteria \(pub. 21 Jun 2024\)](#)

[Corporate Recovery Ratings and Instrument Ratings Criteria \(pub. 02 Aug 2024\)
\(including rating assumption sensitivity\)](#)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

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PPF Telecom Group B.V.

EU Issued, UK Endorsed

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