FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Telenet at 'BB-'; Outlook Stable

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Fitch Ratings - Warsaw - 22 Nov 2024: Fitch Ratings has affirmed Telenet Group Holding N.V.'s (Telenet) Long-Term Issuer Default Rating (IDR) at 'BB-'. The Outlook is Stable. Fitch has also affirmed the group's senior secured debt at 'BB+' with a Recovery Rating of 'RR2'. A full list of rating actions is below.

Telenet's rating reflects its strong market position, scaled network infrastructure that drives strong profitability and operating cash flow. Fibre network capex and entry of a fourth mobile network operator (Digi) could result in mounting competitive pressure and raise leverage, albeit within the rating's thresholds.

The credit profile could be shaped in the short to medium term by Digi's market share gains in Belgium; reductions in Telenet's shareholding of Wyre; a wholesale agreement between Telenet and Orange, giving Telenet access to Wallonia and the remainder of Brussels; and benefits of a potential agreement with Proximus, which could increase fixed market penetration and save on the fibre roll-out plan.

KEY RATING DRIVERS

New Entrant to Increase Competition: Fitch's base case assumes Digi will enter the Belgian consumer market by end-2024, deploying a nationwide 5G network in cooperation with Citymesh, a local B2B operator. We assume Digi gains about 10% of the total mobile subscriber market share in its first five years. This could prove an aggressive assumption if Digi's performance is weaker than expected. However, it does discount a significant proportion of the risk within our financial forecast and provides a strong basis for the rating.

Our base case assumes that, combined with price competition, this would cause Telenet's mobile revenue to drop by around 10% in 2024-2027.

Potential Fibre Deal with Proximus: Telenet and Proximus signed a memorandum of understanding in July 2024 for potential cooperation on fiber roll-out in medium and low-density areas in Flanders. Proximus will build 0.8 million homes in medium-dense areas, while Wyre will cover 1.2 million homes in medium-dense areas and 0.7 million homes in rural areas. The agreement is pending final terms and regulatory approvals.

Key value drivers include reduced network overbuild, increased penetration and network utilisation from the Proximus wholesale traffic in additional to Telenet's and Orange's wholesale access. The deal could save on the initial EUR2 billion fibre-to-the-home (FTTH) roll-out budget, assumed in our base case from 2026 and strengthens the collateral value of Telenet's assets.

Leverage Higher, Within Thresholds: Fitch forecasts EBITDA net leverage to increase to 4.4x by end-2024 from 4.2x at end-2023, and gradually rise towards 4.7x at end-2027. We expect leverage to remain within our rating thresholds of 4.3x to 5.0x. Leverage increased in 2023 due to Telenet's additional EUR890 million debt in 4Q23 and a subsequent EUR1,190 million dividend paid to Liberty Global (LG), which gained a full ownership if Telenet in October 2023. This aligned with previously announced change in target company-defined EBITDA (after leases) net leverage threshold to 4.0x-5.0x from previous 3.5x-4.5x.

FTTH Investments to Drive Leverage: We expect capex to rise to 34%-35% of revenue in 2026-2027 from 32.7% in 2024 (2023: 23.1%), due to the intensified FTTH roll-out. This will result in negative free cash flow (FCF) margins and cash from operations (CFO)-capex/debt over the forecast horizon, leading to a gradual decrease in cash balance and an increase in EBITDA net leverage, but still below the 5.0x downgrade threshold. However, capex above our base case and increased competitive strain could pressure the rating. We do not expect Telenet to pay dividends as long as Telenet remains FCF negative.

Lower EBITDA Margin Remains Flat: We expect the Fitch-defined EBITDA margin to decline to 40.4% in 2024, from 41.9% in 2023, and stabilise at this level over 2025-2027. The lower margin is due to a competitive market, especially before Digi's launch; increased marketing investments; loss of the wholesale contract with VOO MVNO after its acquisition by Orange Belgium; and the ramp-up of entering the Wallonia market and previously unserved communes of Brussels. We expect the margin to remain tempered by intensified competition when Digi unveils its offer.

Ramp-up Phase in New Regions: Telenet gained access to Wallonia and the remaining third of Brussels under a 2023 15-year agreement between Telenet and Orange Belgium, granting each other access to their respective hybrid-fibre coaxial and future FTTH networks. This will solidify Telenet's status as a nationwide fixed-mobile convergence provider. Telenet is currently in a ramp-up phase to build momentum in a new market it has entered with the alternative 'value-for-money' BASE brand. This expansion will involve additional expenses and lower revenue margins due to wholesale costs.

Infrastructure Impact on Credit Profile: Telenet's rating is based on a full consolidation of network infrastructure provider Wyre, in line with the company's financial accounting. A reduction in Telenet's 66.8% stake in Wyre could lead to a proportionate or deconsolidated financial approach to incorporating its ownership in Wyre. It may also lead to a tangible tightening of the leverage thresholds, reflecting the loss of a core operating asset and a change in operating profile.

DERIVATION SUMMARY

Telenet's ratings are driven by a solid operating profile, underpinned by a strong network footprint in Flanders and part of Brussels, expansion in other parts of Belgium through wholesale agreement with Orange Belgium, and a sustainable competitive position. Cash flow generation has been strong, but will be tempered by significant capex related to the fibre roll-out. We expect Telenet's market position to erode gradually, due to our assumption that Digi will increase market share.

Following LG's acquisition of the remaining stake in Telenet in October 2023, Telenet has increased its net debt/EBITDA (after leases) leverage target to 4.0x-5.0x, from the mid-point of a 3.5x-4.5x range, and subsequently increased leverage to 4.2x by end-FY23 through a dividend recapitalisation. This is higher than western European investment-grade telecom peers and more aligned with other peers from the LG portfolio, such as VMED O2 UK Limited (BB-/Negative) and The Sunrise Holding Group (BB-/Negative).

Telenet has a similarly strong operating profile to that of NOS, S.G.P.S, S.A. (BBB/Stable), with higher leverage accounting for Telenet's lower rating. Its revenue visibility is strong across the sector (both investment grade and sub-investment grade).

KEY ASSUMPTIONS

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

- Underlying revenue growth of 0.2%-0.5% in 2024 and 2025 (0.4% in 2024 against 2023 reported figures) and then flat revenue, affected by a decline in mobile revenue following Digi's entrance.

- Fitch-defined EBITDA margin to drop to 40.4% in 2024, from 41.9% in 2023, and remain flat, affected by competitive market environment, wage cost inflation, and increased marketing spend. We forecast EBITDA margins will be affected by additional costs of expansion in Wallonia in 2024 and 2025 and pricing pressures from the fourth market participant in 2025 and beyond.

- Capex/sales ratio (excluding spectrum payments and amortisation of broadcasting rights) of 33.8% in 2024 increasing to around 36% in 2025-2027, driven by Wyre's fibre roll-out ramp-up. Our base case includes some savings in 2026-2027 stemming from the fibre roll-out cooperation with Proximus. Investment plan continues beyond our forecast horizon.

- No dividend payments in 2024-2027.

RECOVERY ANALYSIS

We apply a generic approach to assign instrument ratings for issuers with IDR in the 'BB' rating category. Telenet has only senior secured debt in its capital structure. Therefore, the senior secured debt is labelled as "Category 2 first lien", and we apply 'RR2', reflecting a maximum of two notches uplift from the IDR of 'BB-' for the instrument rating, thus resulting in 'BB+' instrument ratings.

RATING SENSITIVITIES

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

- A weaker operating environment due to increased competition from either mobile or cable wholesale, or a new market entrant, such as Digi, leading to a larger market share loss than Fitch expects and a decrease in EBITDA;

- Fitch-defined EBITDA net leverage consistently above 5.0x and EBITDA interest cover consistently below 4.5x;

- A change in financial or dividend policy leading to higher leverage targets;

- CFO-capex/debt below 3.0% on a sustained basis

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

Positive rating action is unlikely in the short to medium term, given our base case FCF and leverage profiles, but would be driven by the following two factors if performance was better than we expect.

- Fitch-defined EBITDA net leverage falling below 4.3x on a sustained basis;

- CFO-capex/debt above 7.5% on a sustained basis.

LIQUIDITY AND DEBT STRUCTURE

Telenet had a cash balance of EUR961 million at end-September 2024. Telenet's liquidity position is further supported by undrawn revolving credit facilities of EUR590 million due in 2026 (EUR20 million) and 2029 (EUR570 million), and a EUR25 million overdraft facility maturing in 2025.

The group has a long-dated debt maturity profile, with no significant debt maturities until 2028. We expect an unusually high cash position (which is driven by the proceeds from the mobile tower disposal completed in June 2022) to gradually decrease as it is used to support the fibre roll-out plan, most of which is planned by 2029.

ISSUER PROFILE

Telenet is a Belgium-based converged telecom provider, operating mainly in Flanders and some communes of Brussels. It expanded its target market to the remaining part of Brussels and Wallonia in early 2023 through a wholesale agreement with Orange Belgium.

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			RECOVERY	PRIOR
Telenet Financing USD LLC					
senior secured	LT	BB+	Affirmed	RR2	BB+
Telenet Finance Luxembourg Notes S.a r.l.					
senior secured	LT	BB+	Affirmed	RR2	BB+
Telenet Group Holding N.V	LT IDR	BB- Rating Outlook Stable	Affirmed		BB- Rating Outlook Stable
	ST IDR	B	Affirmed		B
Telenet International Finance Sarl					

senior secured	LT	BB+	New Rating	RR2	
senior secured	LT	BB+	Affirmed	RR2	BB+

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Rafal Kaminski
Associate Director
Primary Rating Analyst
+48 22 103 3040
rafal.kaminski@fitchratings.com
Fitch Ratings Ireland Limited spolka z ograniczona odpowiedzialnoscia oddzial w Polsce
Marszalkowska 107, 00-110 Warsaw

Tonya Krokatsis
Associate Director
Secondary Rating Analyst
+44 20 3530 2624
tonya.krokatsis@fitchratings.com

Tajesh Tailor
Senior Director
Committee Chairperson
+44 20 3530 1726
tajesh.tailor@fitchratings.com

MEDIA CONTACTS

Tahmina Pinnington-Mannan
London
+44 20 3530 1128
tahmina.pinnington-mannan@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

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

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Telenet Finance Luxembourg Notes S.a r.l.	EU Issued, UK Endorsed
Telenet Financing USD LLC	EU Issued, UK Endorsed
Telenet Group Holding N.V	EU Issued, UK Endorsed
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