FITCH AFFIRMS CESKA TELEKOMUNIKACNI INFRASTRUCTURA AT 'BBB'/STABLE

Fitch Ratings-London-27 November 2017: Fitch Ratings has affirmed Prague-based Ceska telekomunikacni infrastructura a.s. (CETIN) Long-Term Issuer Default Rating (IDR) at 'BBB'. The Outlook is Stable. A full list of rating actions is given below.

The ratings reflect CETIN's ownership of the telecoms infrastructure in the Czech Republic which includes local loop access, core networks and mobile telecommunications towers. CETIN wholesales its products and services under long-term contracts that guarantee minimum revenue and provide cashflow visibility. These factors reduce the company's business risk profile compared with other fully integrated telecoms operators and underpin a strong cash-generative business model. Funds from operations (FFO)-adjusted net leverage is expected to decline to 3.6x in 2017 from 4.0x at end-2016 and remain comfortably within the limits for a 'BBB' rating.

KEY RATING DRIVERS

National Infrastructure, Reduced Regulation: CETIN was created following the voluntary structural separation of the company from O2 Czech Republic (O2) in 2015. The company owns and operates the incumbent national telecoms infrastructure in the Czech Republic, which it wholesales to all parties on an equal footing. The structural separation and neutral wholesale-based business model enable CETIN to benefit from a lower regulatory burden than other EU based incumbent operators.

Limited Alternative Infrastructure: Outside of Prague and Brno, mobile network access is provided through a 50:50 network-sharing agreement with T-Mobile, enabling both parties to efficiently deliver faster mobile network speeds with better coverage. The only alternative mobile infrastructure on a truly national scale is operated by Vodafone Czech Republic. In fixed access, the largest available alternative is cable operator UPC, covering around 33% of households. There are also numerous local WiFi operators that fragment the broadband market. This leaves limited alternative wholesale infrastructures to CETIN with an equal depth of coverage and capacity.

Cash Flow Visibility and Generation: CETIN's most material contracts with O2, T-Mobile and other operators are based on long-term durations with guaranteed base line revenue commitments. These commitments come with service and capex obligations for CETIN, but provide the company with revenue, opex and capex visibility and the capacity to generate strong EBITDA margins (around 64% excluding international transit). As a result of these agreements, CETIN is able to increase the stability and visibility of cash flows and reduce operational risk.

Manageable Customer Concentration Risk: Around 80% of CETIN's EBITDA is derived from O2 based on long-term agreements. The high dependency of sales on one party creates customer concentration risk. Fitch incorporates a low weighting to this risk in the rating due to O2's strong market position and high switching costs arising from financial and operational factors. Fitch estimates O2 has mobile subscriber market share around 34% and a fixed-line market share of 57%. O2's agreement with CETIN is on a 'take or pay' basis and lasts for an initial seven-year term. This makes O2's business case for alternative suppliers or own network investments prohibitive in all but niche areas.

Deleveraging on Track: Fitch expects FFO-adjusted net leverage to decline to 3.6x (corresponding to net debt/ EBITDA of around 2.8x) by end-2017 from 4.0x at end-2016. The decline is faster than previously expected. Fitch had originally expected CETIN would reach this level in 2019. The reduction in leverage is driven by a combination of strong free cashflow (FCF) generation with pre-dividend FCF margin around 15%-16% and an expected low dividend pay-out ratio in 2017 of around 10% of pre-dividend FCF. The resumption of normative dividend payments in subsequent years is likely to keep FFO-adjusted net leverage broadly stable.

Retained Flexibility Key: CETIN has a measured financial policy, which provides some financial flexibility for managing operational risks. We see the flexibility and current leverage headroom within the rating as important elements as the company expands the breadth and depth of its higher-speed broadband network. The network investment is an essential factor in maintaining the competiveness of its fixed-line network infrastructure, in our opinion, and is an area where CETIN has some vulnerability to the market shares of its wholesale customers.

CETIN has a long-term policy to manage leverage below 3.5x net debt-to-EBITDA based on its definition of the metric, with gradual reduction towards a target of 2.5x after 2020. The company's dividend policy is based on a net income pay-out ratio of up to 100%.

Standalone Rating: CETIN is 100% owned by PPF Group N.V., which also owns 83.3% of O2. CETIN's rating is based on its standalone credit profile and is not affected by its parent or its holdings in other entities. This reflects contractual debt terms such as CETIN having no cross defaults or guarantees to any other part of the PPF group. PPF views CETIN as a long-term strategic investment. PPF plays an advisory role in areas such as corporate funding, procurement and real estate. It holds minimal debt at the holding company level and has no obligation to provide bail-out support for any of its subsidiaries.

Key Operating Risks Unlikely: Fitch has considered four main operational events, which could have an impact on CETIN's credit profile, and concluded that they either have a low risk of occurrence or manageable impact over the next five years. These are the build-out of alternative infrastructures, a sustained increase in capex for network investments, a material loss of broadband market share by O2, and no contractual agreement between O2 and CETIN after the initial seven-year term. These risks form the basis of some of the rating sensitivities below.

DERIVATION SUMMARY

CETIN has a hybrid credit profile due to its focus on wholesale infrastructure provision. The combination of a lower regulatory burden, reduced exposure to retail competition and long-term underlying contracts with minimum revenue streams is unique and reduce the company's operating risks compared with typical, fully integrated telecom operators such as Royal KPN N.V. (BBB/Stable), TDC A/S (BBB-/Stable) or BT Group Plc (BBB+/Stable). This is reflected in CETIN's higher leverage thresholds for any given rating band.

CETIN's operating risk is, however, higher than mobile tower operators such as Cellnex Telecom S.A (BBB-/Negative) in our opinion. Mobile tower operators benefit from higher cash flow visibility and stability as a result of longer-term contracts, minimal technology obsolescence risk, greater visibility of capex investment returns, higher price indexation and, in many cases, energy cost pass-through. In comparison, CETIN's business model benefits from higher barriers to entry as its fixed-line network would be more costly to replicate, but overall, CETIN bears commercial risk for its investments in fixed-line infrastructure that is more similar to traditional, self-sufficient telecom operators.

KEY ASSUMPTIONS

Fitch's key assumptions within the rating case for CETIN include:

- Revenue (excluding international transit) declining around 5% in 2017 and declining by an average of 1% thereafter until 2019;
- EBITDA margin (excluding international transit) improving to 64.5% in 2019 from 63.4% in 2016, reflecting operational efficiencies;
- International transit EBITDA margin remaining stable at 4.6%;
- A weighted average operating lease multiple of 7.5x in 2017 and 7.4x thereafter. This excludes short-term lease expenditure such as vehicles and represents a blended figure that implies a multiple of 8.0x for long-term leased assets such as property and 5.0x for telecoms connectivity;
- Capex of around 20% of total revenue in 2017, declining to 15% by 2019 (excluding international transit around 40% in 2017 and to around 32% by 2019); and
- Shareholder distribution after prioritisation of strategic investment in infrastructure, debt reduction and maintaining net debt-to- EBITDA (as defined by company) below 3.5x.

RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action
- Greater EBITDA diversification in its wholesale customer base and significant growth in broadband market share of CETIN's fibre and xDSL lines;
- Improved visibility of long-term cash flow generation driven by a material increase of committed revenue; and
- FFO-adjusted net leverage falling sustainably below 3.5x.

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action
- A material and sustained decline in EBITDA or FCF driven by pressure in core national business segments;
- A deterioration in the credit quality of O2 Czech Republic driven by a material loss in market share particularly but not solely in the broadband segment;
- A roll-out of alternative network infrastructures that result in a loss of CETIN's market share of fibre and xDSL lines;
- A change in the financial policy of CETIN that results in reduced financial flexibility, higher long-term leverage targets or contractual debt obligations to other parts of the PPF group. Lower financial disclosure at PPF group; and
-FFO-adjusted net leverage trending above 4.0x on a sustained basis.

LIQUIDITY

Comfortable Liquidity: CETIN had CZK366 million of unrestricted cash on its balance sheet at end-1H17. The company generates strong FCF and at end-1H17 had a committed undrawn revolving credit facility (RCF) of CZK500 million and uncommitted undrawn RCF of CZK125 million. CETIN refinanced its debt in 2016, improving its debt maturity profile.

FULL LIST OF RATING ACTIONS

Ceska telekomunikacni infrastructura a.s
-- Long-term IDR: affirmed at 'BBB', Outlook Stable;
CETIN Finance B.V
-- Senior unsecured notes: affirmed at 'BBB'.

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Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable Criteria
Corporate Rating Criteria (pub. 07 Aug 2017)
https://www.fitchratings.com/site/re/901296
Country-Specific Treatment of Recovery Ratings (pub. 18 Oct 2016)
https://www.fitchratings.com/site/re/887669
Non-Financial Corporates Notching and Recovery Ratings Criteria (pub. 16 Jun 2017)
https://www.fitchratings.com/site/re/899659
Parent and Subsidiary Rating Linkage (pub. 31 Aug 2016)
https://www.fitchratings.com/site/re/886557