



Fitch Assigns CETIN's Unsecured Bonds 'BBB(EXP)'; Affirms IDR

Fitch Ratings-London-14 November 2016: Fitch Ratings has affirmed Prague-based Ceska telekomunikacni infrastruktura a.s.'s (CETIN) Long-Term Issuer Default Rating (IDR) at 'BBB'. The Outlook is Stable. The agency has also assigned a senior unsecured rating of 'BBB' to CETIN and an expected rating of 'BBB(EXP)' to the prospective issue of notes by subsidiary, CETIN Finance B.V. under its EMTN notes programme. The final rating of the prospective notes is contingent upon the receipt of final documentation confirming materially to the preliminary documentation reviewed.

CETIN Finance B.V. intends to issue two tranches of notes, denominated in euros and Czech krona. The two tranches are collectively expected to be of benchmark size with a short-to-intermediate tenor. The notes represent senior unsecured obligations and are guaranteed by CETIN. The bond documentation includes provisions for negative pledge and cross default of CETIN and its material subsidiaries. The proceeds from the transaction will be mainly used for general corporate purposes and to refinance existing syndicated loan facilities of CZK27.7bn.

CETIN's rating reflects the ownership of core national network infrastructure in the Czech Republic, long-term contracts that reduce operating risks and drive improved visibility and stability of cash flows, strong cash generating capability and a measured financial policy that is supported by a flexible shareholder remuneration policy. Fitch deems risks related to customer concentration and contract renewal with its main wholesale customer, O2 Czech Republic (O2) as manageable for the rating.

KEY RATING DRIVERS

Core National Infrastructure

Ceska telekomunikacni infrastruktura a.s. (CETIN) is a wholesale-only supplier of mobile and fixed infrastructure in the Czech Republic. The company was created following a voluntary structural separation from O2 Czech Republic a.s. (O2) in 2015 and owns and operates the incumbent national telecoms infrastructure. This includes the fixed local access loop, back bone and mobile. Structural separation enables CETIN to provide wholesale services to all telecoms operators in the Czech Republic on an equal footing. This enables the company to reduce its regulatory exposure to a few core areas.

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 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 33% of households. This leaves limited alternative wholesale infrastructures to CETIN with an equal depth of coverage and capacity.

Manageable Customer Concentration Risk

CETIN derives around 80% of its EBITDA from O2 through long-term agreements. The high dependency of sales on one party creates customer concentration risk. Fitch incorporates a low weighting for this risk in the rating due to O2's strong market position and high switching costs.

O2's Entrenched Position

O2's strong position in the Czech telecoms market benefits from some structural support when compared with other EU incumbents. Fitch Ratings estimates the operator has a 39% share of mobile voice and data service revenues and 42% share of fixed voice and broadband revenues. Investments in pay TV are likely to support further growth and maintain O2's competitive position. Structural support is derived from a three-member mobile operator market, a lack of significant competition from local loop unbundling operators in broadband (around 3% of lines) and low cable coverage.

O2 Unlikely to Switch

Switching costs for O2 are extremely high due to financial and operational reasons. CETIN's agreement is based on significant financial commitments from O2 on a "take-or-pay" basis, which initially last for seven years from June 2015. This makes O2's business case for alternative suppliers or own network investments prohibitive in all but niche areas. O2 owns the customers, retail distribution, mobile spectrum and certain technical platforms, while CETIN owns the network infrastructure.

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 (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.

The revenue commitments reduce the proportion of variable revenue and costs for CETIN and provide greater planning certainty than for typical European telecoms operators. This improves the stability of CETIN's cash flows.

Measured Financial Policy

CETIN has a long-term policy to manage leverage below 3.5x net debt to EBITDA based on its definition of the metric, with a gradual reduction towards a target of 2.5x after 2020. It has a strong underlying pre-dividend free cash flow margin (around 25%-28% excluding international transit) which provides flexibility for increased investment and deleveraging if required. Fitch expects CETIN will progressively increase its dividend to a pay-out ratio of 100% of net income by 2018 from zero in 2016. This should enable it to reduce its funds from operations (FFO) adjusted net leverage to 3.6x by 2019 from 4.5x in 2016. On an underlying basis, normalised for tax and interests costs, CETIN's 2016 FFO adjusted net leverage would be around 4.1x.

Standalone Rating

CETIN is 100% owned by PPF Group N.V., which also owns 84% 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 with, or guarantees for any other part of the PPF group.

PPF considers CETIN a strategic investment. The group views its investment in CETIN as long term. PPF plays an advisory role in areas such as corporate funding, procurement and real estate. PPF holds minimal debt at the holding-company level and has no obligation to provide bail-out support for any of its subsidiaries.

DERIVATION SUMMARY

CETIN has a unique operating profile due to its focus on the provision of wholesale infrastructure of mobile and fixed services in the Czech Republic. The ability to sustain leverage is stronger than for typical European incumbent operators due to long-term contracts that reduce operating risks that drive improved visibility and stability of cash flows, strong cash generating capability and a measured financial policy that is also supported by a flexible shareholder remuneration policy.

KEY ASSUMPTIONS

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

- Revenue (excluding international transit) decline of around 4% in 2016 and broadly stable to marginally declining thereafter.
- EBITDA margin (excluding international transit) improving by one percentage point between 2016 and 2018 to 65% from 64% in 2015, reflecting operational efficiencies.
- International transit revenue and EBITDA to grow at mid-single digit percentage from 2016 to 2018.
- Capex to total revenue at 15%-17% in 2016-2018 and declining thereafter (capex to revenue excluding international transit around 31% in 2017 and 2018).
- Profit distribution subordinated to 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 a significant growth in broadband market share of CETIN fibre and xDSL lines;

- Improved visibility of long-term cash flow generation driven by a material increase of committed revenues;
- 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 free cash flow 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;
- FFO-adjusted net leverage trending above 4.0x on a sustained basis.

LIQUIDITY

Strong Liquidity

CETIN had CZK656m of cash on its balance sheet at the end of 2015. The company generates strong FCF and does not need any additional source of liquidity for the next two years. Under its current capital structure CETIN has no debt maturities until 2018.

Debt Structure

CETIN had CZK28.9bn of debt at end-2015 consisting of the two loan tranches due 2018 (CZK6.9bn) and 2022 (CZK22bn).

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Date of Relevant Rating Committee: 10 November 2016

Summary of Financial Statement Adjustments - Financial statement adjustments that depart materially from those contained in the published financial statements of the relevant rated entity or obligor must be disclosed (in bullet points). Analysts should refer to the relevant section of the Data Control Form and discuss and agree the proposed disclosure at the rating committee. This disclosure should appear after the analyst contact information.

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

Criteria for Rating Non-Financial Corporates (pub. 27 Sep 2016) (<https://www.fitchratings.com/site/re/885629>)

Parent and Subsidiary Rating Linkage (pub. 31 Aug 2016) (<https://www.fitchratings.com/site/re/886557>)

Additional Disclosures

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