Research Update:

Telenet Group Holding N.V. 'BB-' Ratings Affirmed On Expected Partnership With Fluvius; Outlook Stable

October 18, 2022

Rating Action Overview

- We expect that Telenet Group Holding N.V.'s (Telenet's) partnership with Fluvius System Operator (Fluvius) will have a mixed effect on its credit metrics. We forecast that leverage will somewhat improve and free cash flow will be depressed during the period that the newly created network company (netco) upgrades its network to fiber to the home (FTTH).
- Despite the reduced cash flows, we think the company has demonstrated a prudent financial policy as evidenced by its dividend cut, which will support the funding of the network, as well as retaining cash from its mobile telecommunications tower business sale to use for future investments in the network.
- We therefore affirmed our 'BB-' issuer and issue ratings on Telenet and its debt.
- The stable outlook reflects our view that Telenet will demonstrate about 1% organic EBITDA growth in 2022, thanks to the continued solid performance of its broadband segment and price increases. This should translate to S&P Global Ratings-adjusted leverage falling below 4.5x by 2023, partly thanks to lower lease liabilities after partnering with Fluvius.

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Rating Action Rationale

The partnership with Fluvius will slightly reduce Telenet's adjusted leverage, with dividend cuts and its recent tower business sale providing sufficient funding for increased capital expenditure (capex) and macro uncertainties We expect Telenet's adjusted leverage to decline to slightly below 4x in 2023 due to the the removal of the €0.5 billion long-term "erfpacht" lease liability to Fluvius and the meaningful cash balance from the recent sale of Telenet's mobile telecommunications towers (largely offset by a respective lease liability and deferred spectrum liability).

While adjusted leverage should slightly creep toward 4x, as Telenet invests cash to upgrade its network to FTTH, we expect the dividend reduction to €1 per share will cover a large portion of the

increased capex, which we assume will amount to €1 billion over 2023-2026. In addition, the expected leverage reduction provides Telenet with a significant buffer for any operating underperformance during the peak network build period. This is especially important as we expect Telenet will be exposed to wage indexation linked to continued inflationary pressure in 2023, as well as rising electricity costs, and potentially softer demand for broadband upgrades and video products as consumers battle with the increasing cost of living. We currently assume this will mean a slight reduction in Telenet's EBITDA margin in 2023 and, overall, about flat EBITDA compared with 2022 (before the positive effect of removing the lease liability fees to Fluvius). However, we see significant headroom for underperformance versus our current base case within the current rating.

Telenet has demonstrated a track record of a prudent financial policy, reflected by the company sticking to its leverage target as well as its cash flow priorities. We view Telenet's recent actions, including the diversion of cash flows toward network investments instead of shareholder remuneration, sticking to its leverage target, and retaining the proceeds from its recent towers sale, as positives for our view of its financial policy. Therefore, we see very limited risk of an increase in gross debt over the medium term.

We see the combination with Fluvius and planned network upgrade as positive to Telenet's long-term market position, but think the return on investment is not likely to be material in the next two years. We think that the upgrade of the majority of the network to FTTH is a defensive move that will help Telenet maintain its competitive advantage versus competitors, including the incumbent telecom operator Proximus. In addition, we see scope for increased wholesale revenues on the upgraded network based on a greater appetite for alternative fixed line players to access a full fiber network, rather than a cable coaxial network. We also think the full fiber network may be appealing to customers looking to upgrade their contracts, but that creating a significant revenue uptick will likely take more than two years, especially given macroeconomic uncertainties and the rise in household bills.

We do not think that the netco's creation will meaningfully impair Telenet's debt recovery. We understand that the netco will be part of the debt restricted group and act as a guarantor to Telenet's debt facilities. In addition, there will be no external debt at the level of the netco and, hence, we do not see any priority liabilities within the capital structure.

We also expect the valuation of Telenet's stake in the netco to be broadly in-line with the previous network, as Telenet will now own two-thirds of a larger network--compared with full ownership of a network that covers about two-thirds of the netco's coverage. We also think the netco's value should grow over time, thanks to planned investments--offsetting the loss of the tower assets.

Any further sell down of Telenet's stake in the netco could affect our view of the company's business risk profile. This is because we view a purely telecom service company as a riskier business than being a majority owner of the network. Majority ownership has economic benefits that mean significantly higher margins and operating leverage, as well as control over strategic investments in the network. The network also provides a relatively stable stream of high-margin wholesale revenues and could be a differentiating factor compared with competitors.

Outlook

The stable outlook reflects our view that Telenet will demonstrate about 1% organic EBITDA growth in 2022, thanks to the continued solid performance of its broadband segment and price

increases, and about flat EBITDA in 2023, before the positive impact of removing lease liability fees to Fluvius, driven by softer demand and inflationary costs pressures. This should translate to adjusted leverage falling below 4.5x by 2023, partly thanks to lower lease liability after partnering with Fluvius.

Downside scenario

We could lower the rating if Telenet adopted a more aggressive financial policy, leading to an adjusted debt to EBITDA of about 5x or adjusted free operating cash flow (FOCF) to debt (excluding spectrum and the benefit of vendor financing) below 5% for a prolonged period. This could also stem from more fierce competition, causing higher churn, or price pressure with unchanged shareholder remuneration.

We could also lower the rating if Telenet generates persistently negative free cash flow after leases.

Upside scenario

The rating on Telenet is capped at the level of the rating on its parent, Liberty Global PLC (BB-/Stable/--). We could raise the rating on Telenet if we raised the rating on Liberty Global and, at the same time, Telenet tightened its financial policy so as to target adjusted debt to EBITDA of about 4x and FOCF to debt, excluding vendor financing, at or more than 10% sustainably. We regard this scenario as unlikely, given our stable outlook on the parent and our expectation that Telenet will maintain its net leverage target of 3.5x-4.5x.

Company Description

Telenet provides cable TV and telecommunications services to residential and business customers within its service area in parts of Belgium. As of June 30, 2022, the company served about 1.7 million video subscribers, about 1.7 million fixed broadband subscribers, and about 1.1 million fixed telephony subscribers.

Telenet is also the third-largest mobile network operator in Belgium, serving about 2.9 million mobile customers nationwide as of June 30, 2022. Cable subscription revenue, which mainly includes service revenue for TV, broadband, and fixed voice, accounted for 55% of its total first-half 2022 revenue, with the remainder from mobile services (20%) and services for business customers, interconnection, and handset sales (25%).

Telenet is listed on the Euronext stock exchange and majority owned by Liberty Global PLC.

Our Base-Case Scenario

Assumptions

- Revenues increase of about 1% in 2022, due to growing average revenue per user mainly on the back of price increases. We expect the decline in video and fixed voice revenues to offset growth in broadband and mobile service revenues. In 2023, we expect revenue generating unit growth to soften due to fewer upgrades as well as a continued decline in video customers, especially on the back of macro uncertainties and inflation.

- Adjusted EBITDA margins to be slightly higher at 50.0%-50.5% in 2022, from 49.3% in 2021 on lower restructuring charges and tight cost control. In 2023, we expect the adjusted EBITDA margin to increase to about 51% thanks to the removal of fees to Fluvius. This represents a small decline in the EBITDA margin to about 50% on a like-for-like basis due to continued inflationary pressure on wages and energy costs, which will no longer benefit from existing hedging contracts.
- Accrued capex, excluding capex for broadcasting rights and spectrum, as defined by Telenet, of about 25% of sales in 2022, increasing to about 28% in 2023 and about 35% in 2024 as the netco begins FTTH investments.
- Deferred spectrum liability of about €400 million.
- Dividend payout of about €300 million in 2022, and about €110 million from 2023 after the company resets the per share dividend to €1.0 during its build period.

Telenet Group Holding N.V.--Key Metrics*

	--Fiscal year ended Dec. 31--		
	2021a	**2022e**	**2023f**
(Mil. €)			
Revenue growth	0.8	0.5-1	~0.5
EBITDA margin (%)	49.3	50-51	~51
Capex to sales**	24	~25	~28
FFO to debt	18.1	17-18	20-21
Debt to EBITDA (x)	4.4	4.2-4.3	3.8-3.9
FOCF to debt**	7	6-7	~6

*All figures adjusted by S&P Global Ratings. **Accrued capex before vendor financing. Capex--Capital expenditure. a--Actual. e--Estimate. f--Forecast.

Liquidity

We assess Telenet's liquidity as adequate, as we anticipate in our base case that Telenet's sources of liquidity will cover uses by about 1.3x in the 12 months from July 1, 2022. We think that Telenet enjoys solid relationships with banks and a satisfactory standing in the credit markets.

As of July 1, 2022, principal liquidity sources over the ensuing 12 months include:

- Cash balances of €830 million.
- FFO after lease payments of €0.95 billion-€1 billion.

For the same time period, principal liquidity uses include:

- Cash capex of about €700 million-€750 million, including payments for content rights.
- Payment of about €20 million toward spectrum liability repayment.
- Dividend payments of about €110 million.

Covenants

There are no maintenance covenants except a springing covenant for Telenet's revolving credit facilities, setting a maximum of 6x net total debt to EBITDA, as per the covenant definition. We foresee sufficient headroom of more than 50% under this covenant over the next 12 months.

Ratings Score Snapshot

Issuer Credit Rating	BB-/Stable/--
Business risk:	Satisfactory
Country risk	Low
Industry risk	Intermediate
Competitive position	Satisfactory
Financial risk:	Aggressive
Cash flow/leverage	Aggressive
Anchor	bb
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Fair (no impact)
Comparable rating analysis	Negative (-1 notch)
Stand-alone credit profile:	bb-
Group credit profile	bb-
Entity status within group	Strategically important (no impact)

ESG credit indicators: E-2, S-2, G-2

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014

- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed	
Telenet Group Holding N.V.	
Telenet International Finance S.a.r.l.	
Telenet Financing USD LLC	
Issuer Credit Rating	BB-/Stable/--
Telenet International Finance S.a.r.l.	
Telenet Financing USD LLC	
Telenet Finance Luxembourg Notes S.a.r.l	
Telenet Finance VI Luxembourg S. C. A.	
Senior Secured	BB-
Recovery Rating	3(60%)

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