NON-RATING ACTION COMMENTARY

Telenet NetCo Transaction Broadly Neutral to Ratings

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Fitch Ratings-London/Warsaw-26 July 2022: Telenet BV's plan to shift its hybrid fiber-coaxial (HFC) network assets into a joint venture is neutral to the company's ratings, Fitch says following its initial assessment of the transaction. Consolidated group leverage is expected to remain within the company's existing financial policy framework. At the same time, by taking a reduced stake in an enlarged entity, Telenet is likely to offset the impact of partial network ownership and higher long-term retail competition that may arise from an open access network.

Telenet (BB-/Stable) and Flemish grid operator Fluvius have entered into an agreement to combine their HFC and certain fibre network assets into an infrastructure JV (NetCo) with Telenet owning 66.8% and Fluvius 33.2%. The combined assets will cover the whole of Flanders and provide scope to invest up to EUR2 billion (excluding termination-related capex) to upgrade the HFC network to Fiber-To-The-Home (FttH), targeting 78% of Flanders by 2038 with a significant proportion upgraded in the first eight years. NetCo intends to operate on a fully open access basis, providing wholesale access to Telenet and other telco operators. Telenet will fully consolidate NetCo in its reported accounts.

NetCo and its future investments are expected to be funded through a combination of internal cash flow generation at NetCo and intercompany debt by Telenet. NetCo is expected to carry total debt of EUR2.4 billion, which equates to 5.0x net debt to adjusted EBITDA (based on the company's definition). Telenet will be able to maintain consolidated net leverage of around 4x – within the thresholds of its rating – by the reassignment of existing debt to NetCo, a reset of the company's dividend to EUR1 per share that reduces annual dividend payments by EUR200 million a year and proceeds of EUR745 million from tower sales.

NetCo is not expected to pay dividends in the short-to-medium term or while the JV is in a build-out phase. After this phase, Telenet sees scope for material capex reduction at NetCo and potential for dividend payments to shareholders.

The intragroup funding of NetCo with no external debt, ownership that is retained within the lender's restricted group that remains part of the overall security package and intercompany debt that ranks senior to equity claims alleviates any structural subordination of debt held by Telenet at the group level while retaining existing recovery prospects of its senior secured instruments.

Fitch typically views the sale of a significant stake in the entirety of a telecom operator's fixed local access infrastructure as weakening the operating profile of the group. This is due to a reduction in exposure to infrastructure cash flows, which are deemed to carry greater stability, visibility and potentially growth, as fibre adoption increases. (See “What Investors Want to Know: European Telecoms Infrastructure Sales”, published March 2021.)

Fitch views Telenet’s reduced stake in a combined entity that covers the whole of Flanders as largely offsetting this weakness. The creation of an open access network that provides non-discriminatory access to the network to other telecom operators could raise competition to Telenet’s retail business in the long-term. However, the transaction does have defensive qualities in our opinion (such as potentially reducing the scope of overbuilding duplicate networks) while providing optionality for monetisation and further consolidation.

Fitch would view a significant further reduction in Telenet’s holding of NetCo as weakening its operating profile that could also reduce the recovery prospects of its senior secured instruments without a corresponding reduction in gross financial debt. The recovery prospects could also be affected by external financing at NetCo and a sizeable increase in leverage.

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