FITCH AFFIRMS BATELCO AT 'BB+'; OUTLOOK STABLE

Fitch Ratings-London-28 July 2016: Fitch Ratings has affirmed Bahrain-based Bahrain Telecommunications Company's (Batelco) Long-Term Foreign Currency Issuer Default Rating (IDR) at 'BB+'. The Outlook on the IDR is Stable. Fitch has also affirmed the unsecured rating of Batelco International Finance No. 1 Limited at 'BB+'.

The ratings reflect the leading position of Batelco in its competitive domestic market, and its robust ability to generate free cash flow (FCF; excluding spectrum costs). The IDR does not benefit from any uplift for government support as the company's standalone rating of 'BB+' is in line with the sovereign rating. The standalone profile takes into account the political and economic risk of the countries its international operations are in.

KEY RATING DRIVERS
Domestic Market Key
Bahrain is a key market for Batelco, accounting for around 45% of the company's consolidated EBITDA, and a greater proportion of operating FCF. Revenue remains under pressure from intense competition, especially in mobile.

However, Batelco's operating position in its domestic market is improving. Changes in regulation are allowing Batelco to bundle more of its services and the company's fibre rollout is progressing well. Pursuing a convergence strategy, focused on a high-quality fixed and mobile infrastructure should allow Batelco to retain its strong market share in the mid-to-high value consumer segment as well as in the business segment.

We expect domestic revenue trends to improve over the next three years with profitability helped by efficiency gains as Batelco increasingly integrates its fixed and mobile networks and IT infrastructure. FCF should also improve in the coming years as domestic capex should peak in 2016 as Batelco completes the bulk of its fibre rollout and IT upgrades.

International Diversification
Batelco's largest international operations are in the Maldives, Jordan and the Channel Islands. The Maldives and the Channels Islands are performing in line with Fitch's expectations and underlying EBITDA should remain stable over the next three years.

Jordan (around 20% of Batelco's consolidated revenue) is a greater challenge due to its weak macroeconomic trends and higher execution risks as Batelco invests in network expansion. Overall, Batelco has the financial flexibility to support its investment in Jordan, which is reflected in the ratings.

Leverage Remains Low
Fitch's views Batelco's financial profile as strong, underpinned by our expectation of a conservative leverage profile, strong cash flow generation and a sound liquidity profile over the medium term. Fitch projects Batelco's net debt/EBITDA (as defined by Fitch) to increase to 1.1x in 2016 (2015: 0.9x) due to spectrum payments but to remain at or below 1.0x in 2017 and 2018 on improved FCF generation and a conservative shareholder remuneration policy.

Linkage to the Sovereign
Batelco's current rating does not benefit from any uplift for government support, as the company's standalone rating is at the same level as the sovereign. Batelco could benefit from a one-notch uplift from sovereign support if the sovereign rating is higher than Batelco's standalone rating. An

upgrade of the sovereign rating could result in an upgrade for Batelco, provided there is continued support from the government of Bahrain. Batelco as a state-owned entity is highly unlikely to be rated higher than the sovereign, therefore any negative rating action for the sovereign would impact Batelco's rating negatively.

Batelco is 78% directly and indirectly owned by the government of Bahrain. The Bahraini government is invested in Batelco via Bahrain Mumtalakat Holding Company (37%; BB+/Stable), Amber Holding (20%) and the Social Insurance Organisation (SIO; 21%). Bahrain-based diversified investment holding company, Mumtalakat, is 100%-owned by the Bahrain government and is the government's investment arm. Through these entities, the Bahraini government exerts strong control over Batelco, and is represented in six out of 10 Directors on the board, with three being from Mumtalakat (including the Chairman), one from SIO and two from Amber Holding.

KEY ASSUMPTIONS
Fitch's key assumptions within the rating case for Batelco include:

-Revenue growth of 1.5% in 2016, and 1%-1.5% per annum thereafter;
-EBITDA margin largely stable at 35%-36%;
-Capex at 25% of revenue in 2016 due to spectrum costs and network investment, reducing to 15% in 2017 and 2018;
-Annual dividend payments rising in line with EBITDA;
-Net debt/EBITDA as defined by Fitch to reach 1.1x at end-2016 but to remain at or below 1.0x in 2017 and 2018.

RATING SENSITIVITIES
Negative: Future developments that could lead to negative rating action include:

- Negative rating action for the sovereign. Batelco as a state-owned entity is unlikely to be rated higher than the sovereign.

- A weakening of government support, together with deterioration in Batelco's standalone profile, which depends on the following:
(1) Pressure on FCF driven by EBITDA margin erosion, consistently higher capex and shareholder distributions, or significant underperformance in the core domestic market and at other key subsidiaries
(2) Debt-funded acquisitions leading to an increase in funds from operations (FFO) net leverage above 3.5x (1.4x at end-2015) with failure to deleverage below such threshold within the next 18 months

Positive: Future developments that could lead to positive rating action include:
- An upgrade of the sovereign rating with continued support from the government of Bahrain and without any weakening in the linkage with the sovereign.

For the sovereign rating of Bahrain (BB+/Stable), Fitch outlined the following sensitivities in its rating action commentary of 28 June 2016:

The main factors that could lead to negative rating action are:
- Failure to narrow the fiscal deficit sufficiently to stabilise the government debt-to-GDP ratio.
- Severe deterioration of the domestic security environment.

The main factors that could lead to positive rating action are:
- A narrowing of the budget deficit consistent with a decline of the government debt-to-GDP ratio in the medium term.
- A broadly accepted political solution to domestic political tensions.

LIQUIDITY
Batelco had cash and short-term deposits totalling BD160m at end-2015. The company has no significant upcoming debt maturities until its bonds mature in 2020.

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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 Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage (pub. 17 Aug 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869362