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Research Update:

Bahrain Telecommunications Outlook Revised To Negative After Same Action On Bahrain; 'BB-/B' Ratings Affirmed

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Overview

- On June 2, 2017, we revised our outlook on the Kingdom of Bahrain to negative from stable.
- Because of Bahrain Telecommunications' very strong links with the government, the ratings on the sovereign constrain the ratings on the company.
- Consequently, we are revising our outlook on Bahrain Telecommunications to negative from stable, and we are affirming the 'BB-' long-term and 'B' short-term ratings.
- The negative outlook mirrors that on Bahrain, as well as our view that Bahrain Telecommunications is likely to maintain its operating performance and financial leverage comfortably below 4x, despite increased capital expenditures and a high dividend.

Rating Action

On June 5, 2017, S&P Global Ratings revised its outlook to negative from stable on Bahrain Telecommunications Co. (Batelco). At the same time, we affirmed our 'BB-' long-term and 'B' short-term corporate credit ratings on the company.

Rationale

The outlook revision follows our similar action on Bahrain on June 2, 2017 (see "Kingdom of Bahrain Outlook Revised To Negative On Weakening External And Fiscal Positions; 'BB-/B' Rating Affirmed," published on RatingsDirect). We do not rate entities with very strong links to the government, including Batelco, higher than the government itself. This is because the government can influence the entity's financial policy and strategy, industry regulation, and taxation, among other things. The link with the government is manifested through its majority (78%) ownership in Batelco and majority representation on the board (six of the 10 board members are appointed by the government).

We continue to assess Batelco's stand-alone credit profile (SACP) at 'bb+', two notches higher than the long-term rating on the company, pointing to the company's solid operational performance and resilient margins, with an EBITDA margin of 37%, despite the competitive landscape in its home market. We note Batelco's improving mobile market share in Bahrain of 34% and across its international portfolio (namely Jordan), low financial leverage, and strong liquidity, with minimal debt maturities over the coming three years.

The main constraints on Batelco's business risk profile are the company's fairly small scale on a global basis--given that the majority of its operational markets have relatively small populations--the evolving competitive landscape in Bahrain, increased taxes in the international portfolio (Jordan), and its exposure to country risk. Nevertheless, Batelco's demonstrated resilience across the competitive operational markets, with No. 1 or 2 positions in most markets, and relatively high and stable margins offset these constraints.

We expect Batelco's revenue to decline by 1%-2% throughout our forecast period, mainly due to increased competition in Bahrain and Jordan. We expect margins to stabilize around 37%, as we believe the company's cost-reduction initiatives, especially in Bahrain, will help the company withstand current operating challenges. We project that the capital expenditures (capex)-to-sales ratio will increase slightly to 22% in 2017 from 21% at end-2016, mainly due to investments in Bahrain (mobile network and cable and fiber layout deployment), and decline from 2018.

Batelco's financial risk profile is supported by the company's underleveraged balance sheet, with adjusted debt to EBITDA of below 1x, despite sizable investments in networks (2017-2021 average expected capex to sales ratio of 20%) and high dividends (75%-85% of normalized earnings). We expect Batelco to maintain its generous dividend distribution level at Bahraini dinar (BHD) 52 million (about $138 million), given the fiscal pressures of its government shareholder. We forecast the S&P Global Ratings-adjusted debt-to-EBITDA ratio to remain below 1x in 2017 and 2018, and discretionary cash flow generation to stay broadly neutral.

We factor into the rating our negative view of Batelco under our comparable ratings analysis, based on the risks posed by Bahrain's weak fiscal profile, either directly or indirectly, and the significant headroom the company has under its financial policy.

Liquidity

We assess Batelco's liquidity as strong because we expect the company's sources of liquidity will comfortably cover uses by at least 1.5x over the next two years. Furthermore, the company has a long-dated debt maturity profile and is not subject to any financial covenants.

Principal liquidity sources:

- Consolidated cash and equivalents of BHD180 million as of March 31, 2017; and
- Funds from operations that we project will be about BHD118 million over the coming 12 months.

Principal liquidity uses:

- Very minor debt maturities in 2017 and 2018;
- Annual capex of around BHD78 million in 2017 and BHD66 million in 2018; and
- Annual dividends of about BHD52 million.

We are mindful that cash uses may be significantly higher than stated above if acquisition opportunities arise or there are exceptional dividends, which are not factored into our base case.

Outlook

The negative outlook mirrors that on Bahrain, as well as our view that Batelco is likely to maintain its operating performance and adjusted debt to EBITDA comfortably below 4.0x (0.9x on March 31, 2017), despite increased capex requirements and a high dividend.

We may revise down our SACP assessment to 'bb' if Batelco's adjusted debt to EBITDA materially exceeds 2.0x, or if it were substantially above 1.5x alongside weak or negative free operating cash flow. However, an SACP of 'bb' would not affect our view of Batelco's overall creditworthiness, as the rating is already capped by the sovereign rating.

Downside scenario

A further downgrade of the sovereign would likely lead us to downgrade Batelco.

We could also lower the rating on Batelco if its stand-alone credit quality deteriorated substantially, for example if leverage increased materially beyond 4x, or to 3x combined with weak or negative free operating cash flow, although headroom is currently significant. This could result from acquisitions, weakening operating performance (notably in the domestic market), or higher dividends.

Upside scenario

Upside rating potential depends on the sovereign rating, given our view that it constrains the rating on Batelco.

Ratings Score Snapshot

Corporate Credit Rating: BB-/Negative/B

Business risk: Fair
- Country risk: High
- Industry risk: Intermediate
- Competitive position: Fair

Financial risk: Modest
- Cash flow/Leverage: Modest

Anchor: bbb-

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable ratings analysis: Negative (-1 notch)

Stand-alone credit profile: bb+
- Sovereign rating: BB- (rating cap)
- Likelihood of government support: Moderately high

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Telecommunications And Cable Industry, June 22, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- 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 And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Related Research

- Kingdom of Bahrain Outlook Revised To Negative On Weakening External And Fiscal Positions; 'BB-/B' Rating Affirmed, June 2, 2017

Ratings List

Outlook Action; Ratings Affirmed

	To	From
Bahrain Telecommunications Co.		
Corporate Credit Rating	BB-/Negative/B	BB-/Stable/B
Batelco International Finance No. 1 Ltd.		
Senior Unsecured	BB-	BB-

Additional Contact:
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.