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Research Update:

Bahrain Telecommunications Long-Term Rating Lowered To 'B+' After Sovereign Downgrade; Outlook Stable

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Overview

- On Dec. 1, 2017, we lowered our rating on Bahrain to 'B+' from 'BB-' and assigned a stable outlook.
- Our rating on Bahrain caps the long-term rating on Bahrain Telecommunications (Batelco) because we believe the government can influence the company's financial policy and strategy, as well as industry regulation or taxation.
- We are consequently lowering our long-term rating on Batelco to 'B+' from 'BB-', owing to the rating cap, and affirming our 'B+' short-term rating.
- Nevertheless, we still assess Batelco's stand-alone credit profile at 'bb+', owing to the company's low leverage and resilient operating performance.
- The stable outlook on Batelco mirrors that on Bahrain and indicates our expectations that, over the next 12 months, Batelco will face only modest pressure on revenues and its EBITDA margins will stabilize above 35%, with the S&P Global Ratings-adjusted leverage metric staying below 2.0x, despite increased capital expenditures and a high dividend.

Rating Action

On Dec. 5, 2017, S&P Global Ratings lowered its long-term corporate credit rating on Bahrain Telecommunications Co. (Batelco) to 'B+' from 'BB-'. The outlook is stable.

At the same time, we affirmed our 'B' short-term corporate credit rating on the company.

Rationale

The rating action follows a similar action on the Kingdom of Bahrain (see "Kingdom of Bahrain Rating Lowered To 'B+' On Extremely Weak External Liquidity; Outlook Stable," published Dec. 1, 2017, on RatingsDirect). The rating on Batelco is now constrained at the 'B+' level mainly to reflect our view that the government can influence the company's financial policy and strategy, as well as industry regulation or taxation. The company's link with the sovereign is reflected through the government's majority (78%) ownership of Batelco and majority representation on the board (six of the 10 board members are appointed by the government). As a result, we consider that

Batelco is not sufficiently protected from extraordinary negative government intervention in times of stress.

We continue to assess Batelco's stand-alone credit profile (SACP) at 'bb+', three notches higher than the long-term rating on the company. The SACP primarily reflects our view of the company's solid operating performance and resilient margins. We forecast Batelco's EBITDA margin at 34%-37% in 2017-2018, despite the competitive landscape in its three-player home market. We note Batelco's improving mobile market share in Bahrain of 34% and across its international portfolio, 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 (namely Jordan); and its exposure to country risk. Nevertheless, Batelco has demonstrated resilience, with No. 1 or 2 positions in most markets, and relatively high and stable margins.

Batelco's financial risk profile is supported by the company's strong balance sheet, with adjusted debt to EBITDA below 1x, despite sizable investments in networks, with capital expenditure (capex) set to average 20% of sales in 2017-2021, and high dividends (90%-100% of earnings). We expect Batelco will maintain generous dividend distributions of about Bahraini dinar (BHD) 52 million (about \$138 million), given the fiscal pressures of its government shareholder. We also forecast neutral discretionary cash flow generation that breaks even in 2018.

We factor into the rating the risks posed by Bahrain's weak fiscal profile, either directly or indirectly, and the potential risk of releveraging, given the significant headroom the company has under its public financial policy, which translates into S&P Global Ratings-adjusted debt to EBITDA of 0.8x-0.9x in 2017 and 2018.

In our base case, we assume:

- Flat to single-digit revenue growth throughout our forecast period (2017-2019), mainly due to increased competition in Bahrain and Jordan where Batelco generates about 60% of revenues.
- Margins will decline to 34% in 2017 due to restructuring costs, and stabilize thereafter at around 37%, since we believe the company's cost-reduction initiatives, especially in Bahrain, will help it withstand current operating challenges.
- Capex to sales will increase slightly to 22% in 2017 from 20% at end-2016, mainly due to investments in Bahrain (mobile network and cable and fiber layout deployment) and decline from 2018.
- Constant dividends of about BHD52 million, translating into a high payout ratio of close to 100% throughout our forecast period.
- No major debt-financed acquisitions.

Based on these assumptions, we arrive at the following credit measures:

- Adjusted debt to EBITDA of 0.8x-0.9x for 2017-2018.
- Negative discretionary cash flow generation of negative BHD20 million in 2017, compared with positive BHD6 million in 2016, which will then turn positive again in 2018 at BHD2.3 million in 2018.

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 BHD150 million as of Sept. 30, 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 BHD70 million-BHD100 million; 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 stable outlook mirrors that on Bahrain, as well as our view that Batelco is likely to maintain its operating performance and adjusted debt to EBITDA well below 2.0x, despite increased capex requirements and a high dividend.

Downside scenario

A further downgrade of the sovereign would likely lead us to downgrade Batelco, provided we maintain our assessment of Batelco's relationship with the government.

Upside scenario

We could raise our rating on Batelco if the rating on Bahrain was raised, provided we maintain our assessment of Batelco's relationship with the government.

Ratings Score Snapshot

Corporate Credit Rating: B+/Stable/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: B+ (rating cap)
- Likelihood of government support: Moderately high

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- 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: Methodology: Industry Risk, Nov. 19, 2013
- 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: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Kingdom of Bahrain Rating Lowered To 'B+' On Extremely Weak External Liquidity; Outlook Stable, Dec. 1, 2017

Ratings List

Downgraded

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

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