



Fitch Downgrades Batelco to 'BB-'; Outlook Stable

Fitch Ratings-Dubai/London-12 March 2018: Fitch Ratings has downgraded Bahrain Telecommunications Company's (Batelco) Long-Term Issuer Default Rating (IDR) to 'BB-' from 'BB+'. The Outlook is Stable. Fitch has also downgraded the unsecured rating of Batelco International Finance No. 1 Limited to 'BB-' from 'BB+'.

This rating action follows Fitch's downgrade on 1 March 2018 of Bahrain's Long-Term Foreign- and Local-Currency IDRs to 'BB-' from 'BB+'. The Outlook on these ratings is Stable (see "Fitch Downgrades Bahrain to 'BB-'; Outlook Stable" at www.fitchratings.com).

Batelco's 'BB-' IDR is based on its standalone rating of 'BB+', which reflects the company's leading domestic position in a competitive Bahraini market. The standalone rating also takes into account the political and economic risk of the countries in which Batelco has international operations. However, Batelco's rating is limited by Bahrain's 'BB-' sovereign rating as the Bahraini government owns 77% of the company and exerts strong control over it.

KEY RATING DRIVERS

Domestic Market Key: Bahrain is a key market for Batelco, accounting for around 40% of the group's EBITDA. Competition is intense, especially in mobile. However, Batelco's operating position in its domestic market is improving. Pursuing a convergence strategy, focused on a high-quality fixed and mobile infrastructure, should allow Batelco to retain its strong market shares in the mid- to high-value consumer segment and the business segment. Batelco's annual consolidated revenues grew for the first time in 2017 since 2009, while domestic revenues grew 3% y-o-y in 2017.

Profitability should be helped by efficiency gains as Batelco increasingly integrates its fixed and mobile networks and IT infrastructure. Free cash flow (FCF) should improve in the coming years as domestic capex falls as Batelco completes the bulk of its fibre rollout and IT upgrades.

International Operations: Batelco's largest international operations are in the Maldives, Jordan and the Channel Islands. The Maldives business (of which Batelco

owns 52%) generates healthy operating FCF, while reported revenue from the Channels Islands (and the Isle of Man) has stabilised after being hit by GBP weakness over the past two 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.

Increasing Leverage: Fitch views Batelco's financial profile as strong, underpinned by our expectation of a conservative leverage profile, and a sound liquidity profile over the medium term. However, leverage has been slowly increasing with a higher level of capex and increasing dividends. We expect Batelco's funds from operations (FFO) adjusted net leverage (as defined by Fitch) to increase from 1.3x at end-2017 to 1.9x by end-2018, assuming Batelco completes its announced 10% share buyback and maintains its capex profile. We expect FFO adjusted net leverage to stabilise at around 2.0x over the medium term, a level that is low for a 'BB-' rating.

Linkage to the Sovereign: Batelco's standalone rating (ie not factoring in its government ownership) of 'BB+' is higher than the Bahrain sovereign rating of 'BB-'. We do not envisage the company being rated higher than the sovereign as Batelco is a state-owned entity. Any changes to the sovereign rating would therefore likely be reflected in Batelco's rating.

Batelco is 77% 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; 20%). 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 by six of the 10 directors on the company's board: three from Mumtalakat (including the Chairman); one from SIO; and two from Amber Holding.

Batelco's rating is covered by Fitch's Government-Related Entity Criteria. If the Bahrain sovereign rating was higher than Batelco's standalone rating, Batelco would likely be rated one notch below the sovereign rating.

DERIVATION SUMMARY

Batelco's standalone rating is 'BB+', reflecting the company's improving domestic position, low leverage as well as risks to its international operations. We do not

envisage Batelco being rated above the sovereign, especially given the government's significant shareholding in the company. Other telcos in the region such as Etisalat ('A+'/'RWN) and Ooredoo ('A'/'RWN) are much larger and can rely on domestic markets that are less competitive.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Revenue growth of around 1.5% per annum till 2020
- EBITDA margin slightly over 34% till 2020
- Capex (ex spectrum) of around 19% in 2018, declining to below 15% in 2020
- Stable dividend per share till 2020
- Buyback of up to 10% of outstanding shares to take place during 2018, depending on shares availability

RATING SENSITIVITIES

Batelco

Developments That May, Individually or Collectively, Lead to Negative Rating Action

- 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
- FFO net leverage remaining above 4.5x (1.3x at end-2017) with failure to deleverage below such a threshold within the next 18 months
- Any possibility of the sovereign rating being downgraded from 'BB-'. Batelco as a state-owned entity is highly unlikely to be rated higher than the sovereign.

Developments That May, Individually or Collectively, Lead to Positive Rating Action

- An upgrade of the sovereign rating, or a change of the Outlook to Positive, with continued support from the government of Bahrain, without a weakening in the linkage with the sovereign

Bahrain Sovereign

Developments That May, Individually or Collectively, Lead to Positive Rating Action

- A narrowing of the budget deficit consistent with a decline in the government debt/GDP ratio over the medium term
- A broadly accepted political solution to domestic political tensions

Developments That May, Individually or Collectively, Lead to Negative Rating Action

- Failure to shrink the fiscal deficit and set out a clear path towards stabilising the government debt/GDP ratio
- Severe deterioration of the domestic security environment

LIQUIDITY

Strong Liquidity: Batelco has BHD158.7 million of cash on its balance sheet at end-2017, along with BHD62.4 million of short-term deposits treated as restricted cash. Batelco has no immediate material debt maturities, with the company's bonds maturing in 2020 and the long-term loan facility due 2023.

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Summary of Financial Statement Adjustments

Cash and cash equivalents excludes short-term deposits with maturities exceeding three months and unclaimed dividends (BD62m at end 2017), and includes the value of liquid government bonds (BD35m at end 2017).

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Additional information is available on www.fitchratings.com

Applicable Criteria

Corporate Rating Criteria (pub. 07 Aug 2017)
(<https://www.fitchratings.com/site/re/901296>)

Country-Specific Treatment of Recovery Ratings (pub. 18 Oct 2016)
(<https://www.fitchratings.com/site/re/887669>)

Exposure Draft: Corporate Rating Criteria (pub. 14 Dec 2017)

(<https://www.fitchratings.com/site/re/907387>)

Exposure Draft: Country-Specific Treatment of Recovery Ratings Criteria (pub. 14 Feb 2018) (<https://www.fitchratings.com/site/re/10018542>)

Government-Related Entities Rating Criteria (pub. 07 Feb 2018) (<https://www.fitchratings.com/site/re/10019302>)

Non-Financial Corporates Notching and Recovery Ratings Criteria (pub. 21 Dec 2017) (<https://www.fitchratings.com/site/re/914144>)

Parent and Subsidiary Rating Linkage (pub. 15 Feb 2018) (<https://www.fitchratings.com/site/re/10019836>)

Additional Disclosures

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