FitchRatings

Fitch Revises eir's Outlook to Positive; Affirms at 'B'

Fitch Ratings-London-14 April 2016: Fitch Ratings has revised Ireland-based eircom Holdings (Ireland) Limited's (eir) Outlook to Positive from Stable, while affirming its Long-term Issuer Default Rating (IDR) at 'B'. A full list of rating actions is available at the end of this commentary.

eir's business transformation continues on track. Network investment, fibre penetration of the customer base, uptake of the company's TV product, shift in the postpaid mobile mix, and successful wholesale strategy, all point to a stable and improving incumbent business. Revenues have grown in each of the past three quarters and EBITDA for each of the past four quarters, both a function of improving revenues and substantial cost transformation. Management has shown good execution, understanding the need to invest in fibre, taking a measured approach to TV, developing quad-play and capitalising on its wholesale operations.

Fitch expects eir to close financial year to June 2016 with funds from operations (FFO) net leverage of around 5.1x and to be either break-even or marginally positive at free cash flow (FCF) level. Our rating case forecasts net leverage to improve to 4.7x and a FCF margin at 4%-5% in FY17, which combined with eir's strengthening operating profile, would be consistent with a 'B+' rating and supports the revision of the Outlook to Positive.

KEY RATING DRIVERS
Stable & Improving Operating Fundamentals
eir continues to present an increasingly stable business profile. The company's fibre investment has been transformational while its commercial strategy is progressive and delivering solid and increasingly visible financial results.

In a competitive market place, access losses are stabilising, broadband lines and fibre take-up growing well, the former up 9% year on year and fibre penetration at 26% at end-December 2015. Its TV product is proving popular with a small but growing base, while a consistent shift towards postpaid customers, along with ongoing cost efficiencies, has delivered a strong improvement in mobile profitability. eir has delivered group revenue growth in each of the last three quarters and EBITDA growth for four consecutive quarters, an achievement for any incumbent operator.

Infrastructure Transformation
eir's fibre build has so far achieved 1.4 million of its target of 1.9 million homes or 80% of Irish households by end-2020, a target that remains on plan and within budget, which Fitch views has been instrumental to the transformation of the business.

Its TV base is small but the ability to provide an attractive but differentiated TV offer is important in a competitive market. Fitch views the combination of significant fibre investment, and measured approach to content aggregation and acquisition as an effective response in a retail communications market where Sky and Virgin Media are strongly represented. 4G mobile coverage is also being emphasised, with the company expecting coverage exceeding 90% by end-2016, also important in Fitch's view given the data usage and revenue trends in a number of European markets.

Crowded, Competitive Market
Ireland is a fairly small market with a population of around 4.6 million and 2.3 million homes and premises. Despite this Fitch sees the communications market as crowded and competitive, with the fixed

line market facing intense competition from the likes of Virgin Media and Sky and with Vodafone also offering a broadband-only product. Pricing in a recently consolidated - four to three players - mobile market so far shows no signs of easing. The network and commercial transformation at eir has therefore been critical, and the stabilisation in its operating metrics impressive.

The market continues to outperform eir in terms of retail broadband share gains. However, the eir Group generates revenues from Sky and Vodafone, which retail from eir's wholesale segment.

Modest FCF in Sight
The stabilisation of eir's business should lead to greater cash flow generation. While residual restructuring and voluntary leaver costs are likely to impact results through to 2017, these are marginal in terms of the overall cash flow. Fitch believes operating cash flows have been stabilised and are likely to increase over the coming years.

Capex has been the variable that has remained high - mainly as the company's fibre investment plans have been extended to cover a higher proportion of premises and management has chosen to invest selectively in fibre to the premises. Operationally and commercially Fitch believes these investments make sound strategic sense. Our rating case envisages the business turning break-even in cash flow in FY16 and delivering FCF after capex of EUR60m in FY17. This level of performance in 2017, subject to leverage and ongoing operational stability, would be consistent with a 'B+' rating.

Modest Relaxation in Guidelines
eir was first publicly rated in July 2012, at a time when it had exited Irish Examinership, revenues and cash flow were declining dramatically and its network was materially under-invested. Since then management has transformed the business; its network overhauled, its commercial offer materially improved, and revenues, profitability and cash flows stabilised.

Our rating guidelines, which had been set in the context of past operational constraints, have now been loosened moderately. Fitch views eir as an incumbent business that is performing well and which, despite the anomaly of a leveraged balance sheet, is in our opinion now far less likely to see the potential deterioration implied in our previous rating sensitivities. As a result our FFO net leverage guideline for an upgrade to 'B+' has been revised to around 5.0x (previously set at 4.5x) and for a downgrade to 'B-' to above 6.0x (previously set at 5.5x). As FCF improves over time it is possible that sensitivities may be loosened further if and when the ratings move further up the rating scale.

Leverage, Growing Equity Value
Fitch's rating case envisages eir closing FY16 with FFO lease-adjusted net leverage of 5.1x, and reducing to 4.7x by FY17 as FCF turns positive and underlying operating cash flow improves. Leverage at these levels is an anomaly for an incumbent telecom and a function of past private equity ownership. Fitch believes management is committed to reducing leverage, having previously explored the potential of a public listing, and that the possibility for external equity capital exists.

Grey market indications for its privately owned shares imply an equity value of EUR1.1bn and an enterprise value/EBITDA multiple of around 6.9x, based on Fitch's rating case forecast EBITDA for 2016. This kind of multiple is consistent with the wider incumbent telecoms sector.

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

-Low single-digit revenue growth through to FY19
-Stable EBITDA margin of around 39% from FY16 to FY19
-Cash tax above EUR20m p.a. from FY16
-Non-recurring cash outflows related to restructuring provisions and onerous contracts around EUR30m

in FY16 and EUR10m in FY17
-Capital expenditure at 21% of revenues in FY16 and FY17, reducing to 19% and 18% in the following two years
-No further acquisitions beyond Setanta Sports

RATING SENSITIVITIES
Positive: Future developments that may, individually or collectively, lead to an upgrade include:-
-FFO adjusted net leverage expected to remain at or below 5.0x on a sutained basis when combined with,
- FCF margin expected to be consistently in the mid-single digit range,
- Ongoing revenue stability and EBITDA improvement, achieved through the ongoing stabilisation of fixed key performance indicators (KPIs) and improving mobile trends.

Negative: Future developments that may, individually or collectively, lead to a downgrade include:-
-FFO adjusted net leverage approaching 6.0x accompanied by negative FCF. This would imply the stabilisation so far achieved has not been sustained or that competition is continuing to force higher levels of capex than envisaged in our base case, while deteriorating operating trends would be a greater risk.
-A material reversal in positive operating KPI trends - key measures being fixed access losses, overall broadband accesses and the mix in pre- and post-paid mobile customers.

LIQUIDITY
Liquidity is provided by the company's underlying balance sheet cash, which stood at EUR186m at end-2015. Fitch believes this provides sufficient liquidity as the company approaches FCF-breakeven in FY16 and is expected to generate positive FCF in 2017. eir's bank facilities also allow the company to put in place a revolving credit facility.

FULL LIST OF RATING ACTIONS
eircom Holdings (Ireland) Limited
--Long term IDR affirmed at B; Outlook revised to Positive from Stable

eircom Finance Limited
--Senior secured rating: affirmed at 'B+'/'RR3'

eircom Finco S.a.r.l
--Senior secured rating: affirmed at 'B+'/'RR3'

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Summary of Financial Statement Adjustments for the period ended June 2015:-
- Leases: Fitch has adjusted debt by adding 8x yearly operating lease expense related to long term assets; in aggregate approximately EUR440m of lease-adjusted debt to 2015 reported debt,
- Adjustment to reported debt of EUR266m; reflecting that reported debt includes unamortised fair value differences on borrowings, amend-and-extend fees and issue costs.
- Cash flow from operations: Fitch has added back restructuring and provisions payments of EUR56m to eir's reported net cash from operations of EUR295m. These payments relate to voluntary leaver costs and payments for onerous contracts and are expected to reduce materially over time.

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&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOjE0NjA2ODMyNDgsInNlc3Npb25LZXkiOiJQMVBaTVlHSk1NWFRaU0lKSEtZQUVMTVJIRTBGWFRKM09ITEdRQVVGIn0.w-MHFcpPf-aNPgKtDv9rarbEPKtyWlaLm2MZ7waAjhc)
Recovery Ratings and Notching Criteria for Non-Financial Corporate Issuers (pub. 05 Apr 2016) (https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=879564&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOjE0NjA2ODMyNDgsInNlc3Npb25LZXkiOiJQMVBaTVlHSk1NWFRaU0lKSEtZQUVMTVJIRTBGWFRKM09ITEdRQVVGIn0.w-MHFcpPf-aNPgKtDv9rarbEPKtyWlaLm2MZ7waAjhc)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=1002502&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOjE0NjA2ODMyNDgsInNlc3Npb25LZXkiOiJQMVBaTVlHSk1NWFRaU0lKSEtZQUVMTVJIRTBGWFRKM09ITEdRQVVGIn0.w-MHFcpPf-aNPgKtDv9rarbEPKtyWlaLm2MZ7waAjhc)
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