STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

RatingsDirect®

Research Update:

Eir Outlook Revised To Positive On Improved Operating Performance And Deleveraging Prospects; 'B' Rating Affirmed

Primary Credit Analyst:
Osnat Jaeger, London (44) 20-7176-7066; osnat.jaeger@standardandpoors.com

Secondary Contact:
Timo Arponen, London +442071766732; timo.arponen@standardandpoors.com

Table Of Contents

Research Update:

Eir Outlook Revised To Positive On Improved Operating Performance And Deleveraging Prospects; 'B' Rating Affirmed

Overview

- Ireland-based telecommunications group eircom Holdings (Ireland) Ltd. (eir) has posted better revenue growth in the first half of financial year 2016 than we had anticipated.
- We expect a further increase in revenue, EBITDA, and free cash flow over the next 12-18 months, supported by the ongoing benefits of fiber expansion and further cost efficiencies.
- We are therefore revising our outlook on eir to positive from stable. We are affirming our 'B' long-term corporate credit rating on the company and our issue and recovery ratings on its senior secured debt.
- The positive outlook reflects the potential for a one-notch upgrade over the next 12 months if eir continues to grow its revenues, margins, and free cash flow generation in line with our base case, supporting deleveraging to about 5x.

Rating Action

On Feb. 26, 2016, Standard & Poor's Ratings Services revised its outlook on Ireland-based telecommunications group eircom Holdings (Ireland) Ltd. (eir) to positive from stable. At the same time, we affirmed our 'B' long-term corporate credit rating on eir, as well as the 'B' issue rating on the company's senior secured debt. The recovery rating on the debt is unchanged at '3', indicating our expectation of meaningful recovery prospects in the event of default in the lower half of the 50%-70% range.

Rationale

The outlook revision follows eir's better-than-anticipated revenue growth in the first half of the financial year ending June 2016, which has led us to revise upward our base case for the full financial year 2016 and financial 2017. We now forecast 2%-3% revenue growth compared with about 1% revenue decline in our previous base case.

We anticipate a continued increase in postpaid subscribers--who receive a monthly bill, as opposed to paying up front, and generate higher average revenue per user--and growing wholesale revenues as eir increases its coverage of fiber. Revenue growth will also be supported by some targeted price increases and a continued increase in the penetration of "triple play" (broadband, television, and fixed-line telephone) offers, including internet protocol television (IPTV). These offers should be bolstered by the company's recent acquisition of Setanta Sports, which will give eir exclusive access to BT sports content.

Additionally, we expect further EBITDA margin expansion, as we expect a continued reduction in restructuring costs, some additional operating leverage, and benefits from the planned simplification project. We expect the combination of higher EBITDA and our anticipation of free cash flow generation of about €60 million-€70 million in financial 2017 to support deleveraging to less than 5x Standard & Poor's-adjusted debt to EBITDA over the next 18 months. The decline we anticipate in adjusted leverage is also somewhat supported by a decline in the company's defined benefit pension accounting liabilities following their revaluation in December 2015.

Nevertheless, eir's free cash flow generation is still limited at less than €100 million, compared with more than €2 billion of financial debt, which continues to constrain the financial risk profile. This is mainly due to continued high capital expenditure (capex) of €250 million-€300 million per year, of which about two-thirds is dedicated to growth initiatives. We expect limited decline in capex over the medium term as we assume that eir will likely participate in the national broadband plan.

Eir's business risk profile assessment continues to reflect the company's leading positions in the Irish fixed-line telephony and broadband markets, and meaningful presence in the mobile telephony and broadband markets. In our view, the key factor supporting eir's competitive advantage is the company's ability to offer network-based convergent offers, including landline, broadband, mobile, and IPTV. In our opinion, eir's investments in very-high-bit-rate (VDSL) digital subscriber line and fiber-to-the-home (FTTH) support the company's position in the fixed broadband market, and should assist further growth, offsetting the declining legacy voice revenues. Eir's business risk profile is further supported by its solid profitability, with adjusted EBITDA margins expected to exceed 40% in 2017. These strengths are partly offset by the highly competitive fixed-line market in Ireland, with competition from bigger and better capitalized players such as Vodafone and Sky.

Our base case assumes:

- Revenue growth of about 2%-3% in 2016 and 2017, mainly driven by continued increase in broadband revenues (including wholesale) thanks to fiber expansion.
- An increase of about 2 percentage points in EBITDA margins thanks to cost efficiency projects and lower restructuring charges.
- Capex-to-sales ratio remaining relatively high at 19%-21%, as investments in the next-generation network (NGA) and 4G remain high over the medium term.

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

- Adjusted debt to EBITDA of about 5.3x in financial 2016 declining to

about 4.8x in 2017.
- FOCF of €20 million-€30 million in 2016, increasing to €60 million-€70 million in 2017.
- Adjusted EBITDA cash interest coverage of about 4x.

Liquidity

We assess liquidity as adequate under our criteria, reflecting eir's relatively meaningful cash balances and very limited debt amortization.

We estimate that eir's liquidity sources over calendar year 2016 are more than 1.5x uses, which is our numerical threshold for a strong liquidity assessment. We assess liquidity as adequate instead of strong because we forecast headroom under its covenants of less than 30%, and due to eir's limited standing in credit markets and the relatively restrictive terms on the company's bank loans.

We estimate the following liquidity sources:
- About €170 million of unrestricted cash at Dec. 31, 2015; and
- Our forecast of funds from operations of about €350 million.

We estimate the following liquidity uses:
- About €270 million-€290 million of capex;
- Working capital outflows of €10 million-€15 million; and
- Minor cash outflows spent on acquisitions.

We forecast sufficient headroom of more than 20% under all of the senior secured loan's financial maintenance covenants.

Outlook

The positive outlook reflects the potential for a one-notch upgrade over the next 12 months if eir continues to grow its revenues, margins, and free cash flow generation in line with our base case. We expect this to result in deleveraging to about 5x adjusted debt to EBITDA and somewhat strengthen our view of the business risk profile.

Upside scenario

We could upgrade eir if the company's adjusted margins sustainably improve, in line with our base case, to more than 40%, while adjusted leverage falls to about 5x on a sustainable basis. In our view, this would place both the company's business and financial risk profiles at the stronger end of the range for their respective categories.

Downside scenario

We could revise the outlook to stable if revenues and EBITDA fail to grow as a result of increasingly aggressive behaviour by the company's principal competitors, which would constrain medium-term deleveraging.

Ratings Score Snapshot

Corporate Credit Rating: B/Positive/--

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

Financial risk: Highly leveraged
- Cash flow/Leverage: Highly leveraged

Anchor: b

Modifiers
- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Recovery Analysis

Key analytical factors

- The senior secured debt (including €1,863 million term loan facility B3, €159 million term loan facility B2, and €350 million notes) have an issue rating of 'B' and a recovery rating of '3'. The recovery rating is supported by the comprehensive security package but constrained by the priority debt. Recovery prospects are in the lower half of the 50%-70% range.
- Our hypothetical default scenario assumes a continual deterioration in operating performance. We envisage, among other factors, pressure on revenues and operating margins due to competition from alternative providers and new entrants, weaker macroeconomic conditions, and no substantial additional revenues from recent investments in fiber broadband and 4G.
- We value eir as a going concern in view of its established customer base and network assets.

Simulated default assumptions

- Year of default: 2019
- EBITDA at emergence: €324 mil.
- Implied enterprise value multiple: 5x
- Jurisdiction: Ireland

Simplified waterfall

- Gross enterprise value at default: €1,620 mil.
- Administrative costs: €21 mil.
- Net value available to creditors: €1,539 mil.
- --Recovery expectation: 50%-70% (low half of the range)

*All debt amounts include six months of prepetition interest.

Related Criteria And Research

- Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Telecommunications And Cable Industry, June 22, 2014
- Group Rating Methodology, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria Guidelines For Recovery Ratings On Global Industrial Issuers' Speculative-Grade Debt, Aug. 10, 2009

Ratings List

Ratings Affirmed; Outlook Action

	To	From
eircom Holdings (Ireland) Ltd.		
Corporate Credit Rating	B/Positive/--	B/Stable/--

Ratings Affirmed

eircom Finance Ltd.	
Senior Secured*	B
Recovery Rating	3L
eircom Finco S.a.r.l.	
Senior Secured*	B
Recovery Rating	3L

*Guaranteed by eircom Holdings (Ireland) Ltd.

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@standardandpoors.com

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 Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's 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.