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Ratings

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Bahrain Telecommunications Co.

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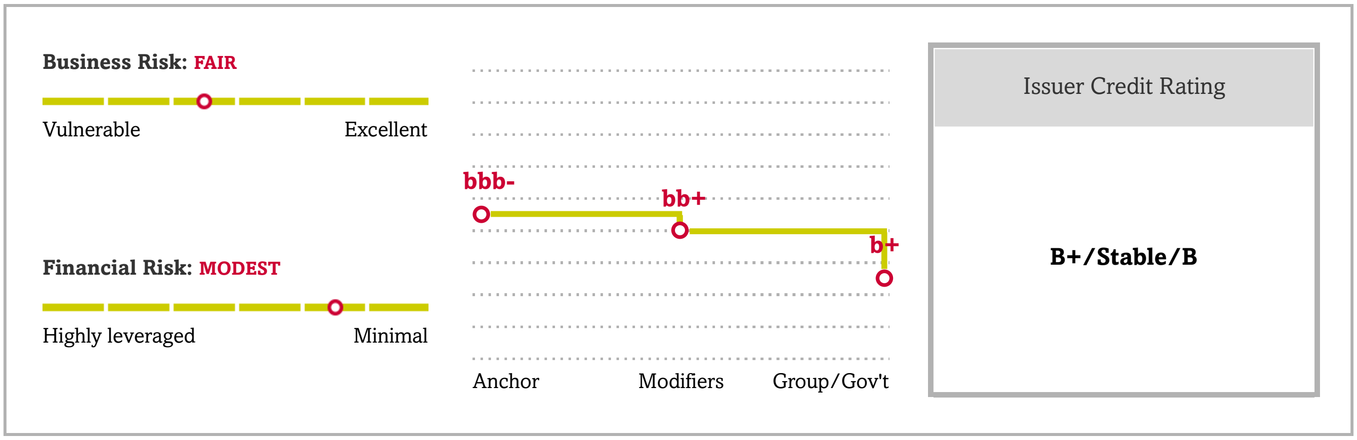
Bahrain Telecommunications Co.



Credit Highlights

Overview

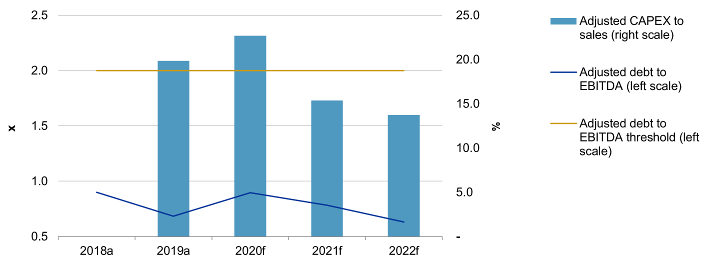
Key strengths	Key risks
Solid position in its domestic market, benefiting from a more favorable regulatory environment, and No. 1 or No. 2 positions in most international markets.	Smaller scale compared with global and regional peers, with operations in the highly competitive three-player Bahraini telecom market contributing about 45% of company revenues.
Continued focus on cost efficiencies supporting our expectation of consistent profitability (over 35% EBITDA margin on an S&P Global Ratings-adjusted basis).	Sizable capital expenditure (capex) due to network upgrades, fiber rollouts, and license renewals, and significant dividends (90%-100% payout ratio), both weighing on discretionary cash flow generation.
Strong balance sheet with adjusted debt-to-EBITDA expectation below 2.0x.	Increased taxes in international portfolio, most notably in Jordan.
	A very strong link to the Bahraini government (B+/Stable), which could expose it to extraordinary negative intervention in times of sovereign stress.

Softer performance this year as limited mobility, restricted travel, and lower population add pressure to the top line, but our base case points to resilient profitability. We have lowered our revenue forecast for 2020 on the weaker macro picture in key markets related to COVID-19 and the oil price decline, along with an increasingly competitive landscape. Nevertheless, we expect Bahrain Telecommunications Co.'s (Batelco's) margins to remain in the mid-to-high 30s over the next two-to-three years, on an S&P Global Ratings-adjusted basis. This is supported by the company's cost efficiency initiatives and focus on digitization across its key markets (mainly Bahrain, which comprises 40%-45% of consolidated revenue and EBITDA), along with continued rationalization in the portfolio and a focus on high-value markets and products.

Credit metrics comfortably below 2.0x, even in 2020. In our base case, we expect continued sizable investments in mobile network expansion, fiber upgrades, and mobile license renewals over the next two years--with capex to sales of around 15%-25% in 2020 and 2021. We also expect the company to maintain a high payout ratio (90%-100%), similar to historical levels. Even so, we anticipate leverage to remain around 0.8x-1.0x, which is much lower than the 2.0x downgrade trigger for the rating, supported by high margins consistently above 35%, and a solid balance sheet.

Chart 1

Leverage Versus Capex



a--Actual. f--Forecast. Capex--Capital expenditure. Source: S&P Global Ratings.
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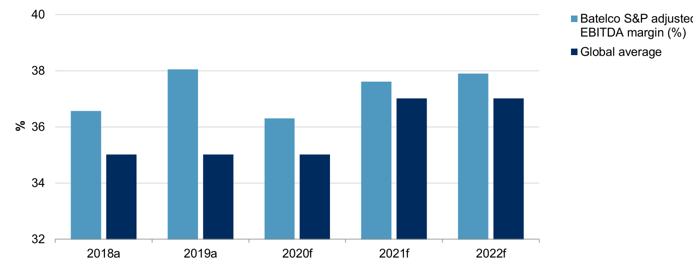
Chart 2

Profitability Versus Global Average



a--Actual. f--Forecast. Source: S&P Global Ratings.
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Outlook: Stable

Our stable outlook on Batelco mirrors that on Bahrain. It also reflects our view that Batelco is likely to maintain its operating performance and adjusted debt to EBITDA well below 2.0x (0.7x for 2019), despite increased capex requirements and high dividends.

Downside scenario

We could lower our rating on Batelco if we took a similar action on Bahrain, 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.

Our Base-Case Scenario

Assumptions

- Overall weaker macro environment in key operating markets, reflecting subdued oil prices and COVID-19 restrictions on economies. For Bahrain, we expect GDP and population decline in 2020 of 5% and 2%, respectively, before recovering in 2021 onward to low-single-digit growth.
- Mid-single-digit contraction in revenues for 2020, mainly reflecting the effects of COVID-19 on operations, and to a lesser extent the impact of deconsolidating Qualitynet (3% of consolidated revenues). While the dynamics of each operating market varies, we generally anticipate a top-line decline across the board for 2020.
- We expect Bahrain revenues (40%-45% of consolidated revenue) to decline in tandem with our expectations of population decline in 2020. While we anticipate that demand for broadband data could increase, we view the impact from roaming data and international revenues, related to travel restrictions and limited mobility from COVID-19, as offsetting. In the international portfolio, we expect the Jordanian segment to be further undermined by the new

Long Run Incremental Cost (LRIC) mobile termination rates.

- The company's major capex plans in mobile network expansion and 5G rollout should continue to fuel broadband growth, and its upselling strategy to further increase ARPU growth, in addition to continued fiber rollout in fixed broadband.
- EBITDA margin to dip to 35%-36% in 2020 on an S&P Global Ratings-adjusted basis, compared with 38% in 2019, reflecting some erosion in high-value segments such as roaming. We note that EBITDA margin for 2020 excludes the low margin Qualitynet business, which was sold in May 2019.
- Capex of BHD80 million-BHD90 million in 2020 (compared to BHD79.4 million in 2019) due to fiber network expansion and mobile license renewal in Bahrain, and cable investments in the Maldives. We expect capex will peak in 2020 before declining to BHD55 million-BHD60 million in 2021.
- Annual dividends (including to minorities) of about BHD55 million, translating into a payout ratio of about 90%.

Key Metrics

Mil. BHD	**2018a**	**2019a**	**2020e**	**2021f**	**2022f**
Revenue growth (%)	7	(1.1)	(4) - (6)	0 - 2	2 - 3
EBITDA margin (%)*	36.6	38.0	35 - 38	37 - 40	37 - 40
Capital expenditure *	48.3	79.4	80 - 90	50 - 60	50 - 60
Debt to EBITDA (x) *	0.9	0.7	0.8-1.0	0.8-1.0	0.6 - 0.8
FFO to debt (%) *	96.3	127.9	100-110	115-125	155-165
FOCF to debt (%)*	48.6	55.4	25-30	60-65	90-95

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

We anticipate the pre-paid and SME segments, and exposure to tourism in key markets, to affect overall growth in 2020. We believe restricted mobility and population decline will negatively impact SMEs and low-value pre-paid customers, given that these segments will be the first to be hit by the economic slowdown. We also expect some erosion from high-margin value-added services such as roaming and international revenues as travel restrictions stay in place, and purchasing power weakens. In particular, we expect markets with more reliance on tourism, such as the Maldives, to be more severely affect by the latter, compared markets like Jordan where roaming is less significant.

Healthy free cash flow generation, despite capex peak in 2020. We expect the ratio of capex to sales to reach 20%-25% in 2020, following 20% in 2019, before declining gradually to around 15% by 2022. This reflects higher investments due to 5G rollouts and network digitization--which we understand will continue as planned despite mobility restrictions--in addition to the fiber rollout, along with license renewals in Bahrain. With margins above 35%, and minimal working capital requirements, we expect positive free cash flow generation to debt will rebound to well above 25% from 2021 as capex subsides.

Company Description

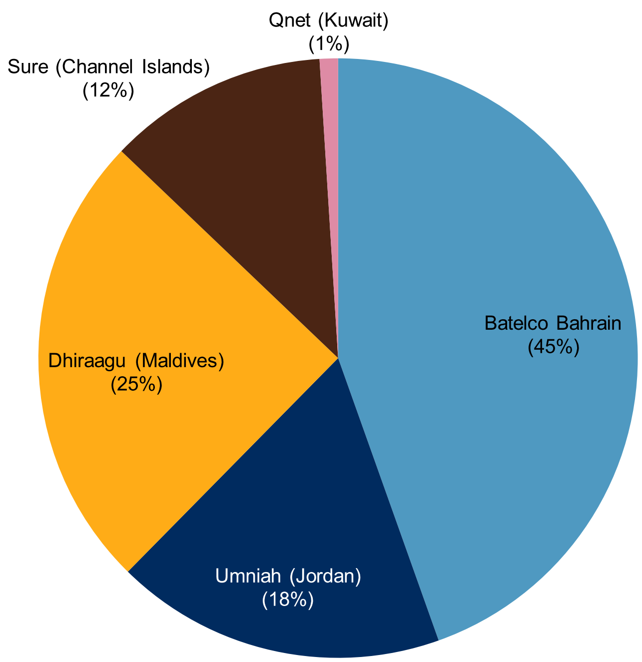
Batelco is a Bahrain-based integrated telecom operator providing mobile, fixed telephony, and broadband services across Bahrain, Jordan, the Maldives, some British islands (including Guernsey, Jersey, and the Isle of Man), and Yemen (through its 27% shareholding). Batelco's revenues reached BHD401.5 million ($1.06 billion) in fiscal year ended Dec. 31, 2019 (FY2019), with a total subscriber base of 8.3 million.

In May 2019, Batelco announced the completion of the sale of its 90% stake in Kuwait-based Qualitynet to VIVA Kuwait, a subsidiary of Saudi Telecom Co. (A-/Stable/A-2).

The Bahraini government, through three Bahraini-related entities, owns a 77% stake in the group, with the remaining 23% floated on the Bahrain Stock Exchange.

Chart 3

Segmental Breakdown By EBITDA FY 2019



Source: Company reports.

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Peer Comparison

Table 1

Bahrain Telecommunications Co.--Peer Comparison					
Industry sector: Diversified telecom					
	Bahrain Telecommunications Co.	**Saudi Telecom Co.**	**Emirates Telecommunications Group Company PJSC**	**Ooredoo Q.P.S.C.**	**Turk Telekom**
Ratings as of June 11, 2020	B+/Stable/B	A-/Stable/A-2	AA-/Stable/A-1+	A-/Stable/A-2	BB-/Stable/B
	--Fiscal year ended Dec. 31, 2019--				
(Mil. $)					
Revenue	1,064.7	14,492.8	14,207.9	8,216.7	3,975.7

Table 1

Bahrain Telecommunications Co.--Peer Comparison (cont.)

Industry sector: Diversified telecom

	Bahrain Telecommunications Co.	Saudi Telecom Co.	Emirates Telecommunications Group Company PJSC	Ooredoo Q.P.S.C.	Turk Telekom
EBITDA	404.9	5,678.7	6,312.0	3,531.8	1,739.5
Funds from operations (FFO)	353.7	5,354.9	5,489.0	2,808.8	1,341.1
Interest expense	40.9	229.5	329.6	653.5	429.5
Cash interest paid	32.6	125.7	310.0	584.0	372.0
Cash flow from operations	363.7	2,700.2	5,337.7	3,349.8	1,450.9
Capital expenditure	210.6	3,030.4	2,385.6	1,685.3	702.6
Free operating cash flow (FOCF)	153.1	(330.3)	2,952.1	1,664.5	748.4
Discretionary cash flow (DCF)	1.9	(3,557.3)	629.5	1,291.0	748.4
Cash and short-term investments	537.2	2,722.3	8,057.0	3,805.7	742.4
Debt	276.5	3,221.4	771.5	8,185.4	3,081.6
Equity	1,361.5	16,808.6	15,727.3	7,994.1	1,586.9
Adjusted ratios					
EBITDA margin (%)	38.0	39.2	44.4	43.0	43.8
Return on capital (%)	14.6	18.7	27.3	7.8	24.3
EBITDA interest coverage (x)	9.9	24.7	19.1	5.4	4.0
FFO cash interest coverage (x)	11.9	43.6	18.7	5.8	4.6
Debt/EBITDA (x)	0.7	0.6	0.1	2.3	1.8
FFO/debt (%)	127.9	166.2	711.5	34.3	43.5
Cash flow from operations/debt (%)	131.5	83.8	691.9	40.9	47.1
FOCF/debt (%)	55.4	(10.3)	382.6	20.3	24.3
DCF/debt (%)	0.7	(110.4)	81.6	15.8	24.3

Batelco enjoys solid profitability (EBITDA margin of over 35%) with a strong balance sheet position (adjusted net debt to EBITDA below 1.0x) in FY2019.

Compared with Turkish peers, Batelco is much smaller in scale, but has a stronger balance sheet.

Compared with GCC peers we see Ooredoo as the closest peer in terms of stand-alone rating. We view Ooredoo as stronger, given its larger scale, greater geographical diversity, and slightly higher profitability, which is mainly a reflection of the more-favorable competitive landscape in Qatar (a duopoly, compared with Bahrain's three-player market). Nevertheless, we note that Batelco enjoys a stronger balance sheet (leverage below 1.0x versus Ooredoo's 2.0x-2.5x ratio), which gives it a better financial standing to withstand the high capex needs and sizable dividends both operators face.

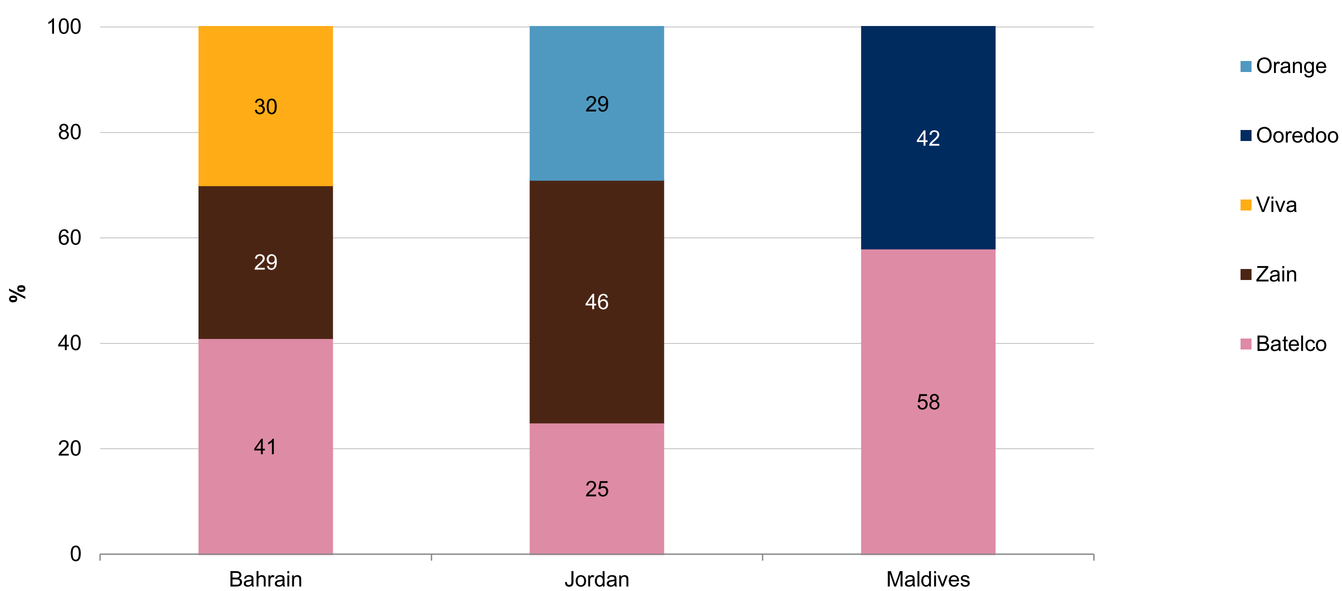
Business Risk: Fair

Batelco's business risk profile assessment primarily reflects our view of the company's solid operating performance and resilient margins, but balanced by the group's limited scale compared to global and regional peers, and its exposure to challenges in its international portfolio.

We note Batelco's improving mobile market share in Bahrain (41%), and leading No. 1 and No. 2 positions across its international portfolio. The main constraints on Batelco's business risk profile assessment are its 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 in Jordan); and its exposure to country risk.

Chart 4

Mobile Subscriber Share By Geography (FY2019)



Source: Company reports.

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Financial Risk: Modest

Batelco's financial risk profile is supported by the company's strong balance sheet, with adjusted debt to EBITDA of about 1.0x, despite sizable investments in networks, with capex set to reach 20%-25% of sales in 2020, and high dividends (90%-100% of earnings). We expect Batelco will maintain generous dividend distributions of BHD50 million-BHD55 million. We also see a potential for negative discretionary cash flow generation in 2020, due to lower revenues and high capex.

Financial summary

Table 2

Bahrain Telecommunications Co.--Financial Summary

Industry sector: Diversified telecom

	--Fiscal year ended Dec. 31--				
	2019	**2018**	**2017**	**2016**	**2015**
(Mil. BHD)					
Revenue	401.5	405.9	379.4	367.1	372.4
EBITDA	152.7	148.3	135.4	137.1	137.0
Funds from operations (FFO)	133.4	128.5	117.8	119.0	118.7
Interest expense	15.4	15.0	13.1	13.3	10.0
Cash interest paid	12.3	13.7	11.9	12.1	10.3
Cash flow from operations	137.1	113.2	93.2	130.3	125.5
Capital expenditure	79.4	48.3	54.2	72.6	93.9
Free operating cash flow (FOCF)	57.7	64.9	39.0	57.8	31.5
Discretionary cash flow (DCF)	0.7	12.4	(15.9)	6.2	(18.7)
Cash and short-term investments	202.6	142.8	158.7	172.4	160.0
Gross available cash	202.6	155.6	158.7	172.4	160.0
Debt	104.3	133.5	115.3	119.6	125.6
Equity	513.4	504.9	502.5	537.0	573.1
Adjusted ratios					
EBITDA margin (%)	38.0	36.6	35.7	37.4	36.8
Return on capital (%)	14.6	11.7	10.8	10.4	10.5
EBITDA interest coverage (x)	9.9	9.9	10.3	10.3	13.7
FFO cash interest coverage (x)	11.9	10.4	10.9	10.8	12.6
Debt/EBITDA (x)	0.7	0.9	0.9	0.9	0.9
FFO/debt (%)	127.9	96.3	102.1	99.5	94.5
Cash flow from operations/debt (%)	131.5	84.8	80.8	109.0	99.9
FOCF/debt (%)	55.4	48.6	33.8	48.3	25.1
DCF/debt (%)	0.7	9.3	(13.8)	5.2	(14.9)

BHD--Bahraini dinar.

Reconciliation

Table 3

Bahrain Telecommunications Co.--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (mil. BHD)

	--Fiscal year ended Dec. 31, 2019--					
Bahrain Telecommunications Co. reported amounts						
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**
Reported	237.7	473.1	141.7	75.5	152.7	143.4

Table 3

Bahrain Telecommunications Co.--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (mil. BHD) (cont.)						
S&P Global Ratings' adjustments						
Cash taxes paid	--	--	--	--	(7.0)	--
Cash interest paid	--	--	--	--	(12.3)	--
Reported lease liabilities	44.2	--	--	--	--	--
Postretirement benefit obligations/deferred compensation	--	--	(0.1)	(0.1)	--	--
Accessible cash and liquid investments	(182.3)	--	--	--	--	--
Asset-retirement obligations	3.2	--	--	--	--	--
Nonoperating income (expense)	--	--	--	5.3	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	(6.3)
Noncontrolling interest/minority interest	--	40.3	--	--	--	--
Debt: Guarantees	1.5	--	--	--	--	--
EBITDA: Other	--	--	11.1	11.1	--	--
Total adjustments	(133.4)	40.3	11.0	16.4	(19.3)	(6.3)
S&P Global Ratings' adjusted amounts						
	Debt	**Equity**	**EBITDA**	**EBIT**	**Funds from operations**	**Cash flow from operations**
Adjusted	104.3	513.4	152.7	91.8	133.4	137.1

BHD--Bahraini dinar.

Liquidity: Adequate

As of March 31, 2020, we assess Batelco's liquidity as adequate over the next 12 months because we estimate its liquidity sources will exceed uses by 1.2x.

Principal Liquidity Sources	Principal Liquidity Uses
• Consolidated cash and equivalents of about BHD211 million; • Undrawn bank lines of about BHD183.4 million (including the USD450 million term loan that was used to refinance the bond); • Funds from operations that we project will be about BHD120 million-BHD130 million over the coming 12 months; and • Proceeds from a term loan of BHD171 million to partly refinance the upcoming debt maturity.	• Debt maturities of BHD200 million in the next 12 months; • Annual capex of BHD80 million to BHD90 million for the next 12 months; and • Annual dividends of about BHD55 million. We do not account for share buyback plans announced by the company as it is not a contracted cash outflow. 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.

Debt maturities

As of March 31, 2020

- 1 year: $527.5 million ($473 million outstanding bond was refinanced in May 2020)
- 1-2 years: $44.2 million
- 3-5 years: $67.3 million

Covenant Analysis

We understand that the $450 million term loan is subject to a maximum net debt (including letters of credits, guarantees, and finance leases) to EBITDA covenant of 3.0x (reported net debt to EBITDA of 0.8x as of March 30, 2020) and minimum tangible net worth of BHD100 million (reported BHD163 million as of March 30, 2020). We expect significant headroom under the covenants.

Other Credit Considerations

We factor into the rating our negative view of Batelco compared with its rated peers, based on direct and indirect risks posed by Bahrain's weak fiscal profile, and the company's financial policy, which is significantly looser than current leverage ratios.

Government Influence

We consider Batelco to be a government-related entity (GRE) due to the sovereign's stake of about 77% in the company. Our view of a moderately high likelihood of extraordinary government support is based on our assessment of Batelco's:

- Limited importance for the government, given that increased competition in the Bahraini telecoms market has resulted in a meaningful market share decline for Batelco. It also reflects our view that the Bahraini telecoms regulator is independent from the government, especially compared with the majority of other Gulf Cooperation Council countries, where the introduction of competition has not significantly affected incumbent telecoms operators. Therefore we believe that the Bahrain government might have less incentive to support Batelco; and
- Very strong link with the government, since the government owns about 77% of the company. Furthermore, the majority of Batelco's board comprises members of the government.

Given Batelco's very strong link with the government, our rating on Bahrain caps the company's long-term rating because we believe the government can influence Batelco's financial policy and strategy, as well as industry regulation or taxation.

Issue Ratings - Subordination Risk Analysis

Capital structure

Batelco's capital structure primarily comprises a term loan of $450 million (BHD172 million). This represents around 80% of gross debt, which is raised at the parent level.

Analytical conclusions

Given that 80% of gross debt is at the parent level and Batelco has a strong balance sheet, this should help it offset subordination risks.

Ratings Score Snapshot

Issuer 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)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Fair (no impact)
- **Comparable rating analysis:** Neutral (-1 notch)

Stand-alone credit profile : bb+

- **Related government rating:** B+
- **Likelihood of government support:** Moderately high

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- 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: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Bahrain Outlook Revised To Stable From Positive On Low Oil Price Outlook; 'B+/B' Ratings Affirmed, March 27, 2020
- Bahrain Telecommunications Outlook Revised To Stable From Positive In Line With Sovereign; 'B+/B' Ratings Affirmed, April 1, 2020

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	**Modest**	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	**bbb-**	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of July 14, 2020)*	
Bahrain Telecommunications Co.	
Issuer Credit Rating	B+/Stable/B
Issuer Credit Ratings History	
01-Apr-2020	B+/Stable/B
10-Dec-2019	B+/Positive/B
05-Dec-2017	B+/Stable/B
05-Jun-2017	BB-/Negative/B
12-Dec-2016	BB-/Stable/B
22-Feb-2016	BB/Stable/B

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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