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Fitch Affirms Batelco at 'B+'; Outlook Stable

Fitch Ratings - London - 10 Jun 2021: Fitch Ratings has affirmed Bahrain Telecommunications Company's (Batelco) Long-Term Issuer Default Rating (IDR) and senior unsecured rating at 'B+'. The Outlook is Stable. A full list of rating actions is provided below.

The IDR of Batelco is linked to Bahrain's sovereign rating (B+/ Stable), reflecting its 77% ownership and strong control by the Bahraini government. Batelco's Standalone Credit Profile (SCP) of 'bb+' is higher than its IDR. The SCP reflects a balance between its strong position in its domestic market, which drives nearly half of its adjusted operating cashflows, and the political and economic risks of the countries in which Batelco has international operations. These risks are effectively managed though a conservative financial approach.

Key Rating Drivers

Profitable Growth Despite Covid-19: Batelco reported a 4% revenue decline in 2020, primarily as a result of declines in legacy products and weaker mobile roaming due to the impact of coronavirus measures. It was able to effectively offset these at the underlying EBITDA level (adjusted for right-of-use asset depreciation and interest on lease liabilities), which grew 9% YoY due to lower operating expenses. The lower operating cost structure should support continued EBITDA growth this year.

Domestic Market Underpins Rating: Bahrain is a key market for Batelco, accounting for 47% of total revenue and adjusted EBITDA in 2020. Its operating position in its domestic market is improving following the deployment of its fibre network. However, competition in the mobile segment remains intense as third mobile operator STC Bahrain tries to build revenue market share. Pursuing a convergence strategy focused on a high-quality fixed and mobile infrastructure is allowing Batelco to retain its strong market shares in the mid- to high-value consumer segment and the business segment.

Bahrain Network Separation: The separation of Batelco's network into two legal entities is a regulatory requirement. The separation (similar to BT Group in the UK) creates a separate fixed-line entity that has the obligation to serve both internal and external wholesale customers equally without discrimination. The separation may create greater competitive pressure on retail broadband prices in the short- to- medium term. Should these pressures materialise, we do not expect them to have a significant impact on the rating given the level of wholesale prices, potential for growth in the wholesale division and Batelco's moderate leverage.

Diverse International Operations: Batelco's largest international operations are in the Maldives, Jordan and the Channel Islands. Batelco has a number one or two market position in most of its international markets that enable them to generate strong free cashflow. In Jordan (about 20% of adjusted group

EBITDA), Batelco is a market challenger, with a 25% share in the mobile market. It is gradually building scale and deploying fibre in partnership with local electricity utilities, which should support its market position and drive growth from broadband and convergent services. The economic and political risks of some Batelco's international markets restrains the group's SCP.

Portfolio Reshaping: Batelco's strategy is to optimise the group's core businesses and grow beyond the core network connectivity business. This could involve investing in select segments that have strong digital growth potential. Batelco has a conservative financial profile to support the strategy implementation and reshaping of portfolio.

Low Leverage: Fitch views Batelco's financial profile as strong, underpinned by our expectation of a conservative leverage profile, and sound liquidity over the medium term. We expect funds from operations (FFO) net leverage to stabilise at around 0.5x over the medium term (versus 0.6x at end-2020), a level that is low for the 'B+' rating.

Strong State Influence: The Bahraini government is invested in Batelco via Bahrain Mumtalakat Holding Company (37%; B+/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 eight of 10 directors on the group's board: four from Mumtalakat (including the Chairman); two each from SIO and Amber Holding.

GRE Criteria Application: Batelco's IDR is constrained by the sovereign's based on Fitch's Government-Related Entities (GRE) Rating Criteria and Parent and Subsidiary Rating Linkage Criteria. Under the GRE Rating Criteria we assess status, ownership and control; support track record and expectations as well as financial implications of a GRE default as 'Strong'. We view socio-political impact of a GRE default as 'Moderate'.

Derivation Summary

The SCP of 'bb+' of Batelco reflects its incumbent position in its domestic market, low leverage as well as risks to its international operations. We do not envisage Batelco being rated above the sovereign rating, especially given the government's significant shareholding in the company and strong ties between the group and the state. Oman Telecommunications Company S.A.O.G. (Omantel; BB-/Negative) is of similar size, with its rating similarly capped by the sovereign rating. Other telcos in the region such as Emirates Telecommunications Group Company PJSC (Etisalat; A+/Stable) and Ooredoo Q.P.S.C. (A-/Stable) are much larger and can rely on domestic markets that are less competitive, as well as on government support.

Key Assumptions

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

- Reported revenue growth of 2%-3% per year in 2021 to 2023

- Adjusted EBITDA margin around 37.5%% in 2021 and gradually increasing to over 38% by 2023

- Right-of-use asset depreciation and interest on lease liabilities at BHD11 million-BHD12 million for the next three years

- Capex at around 25% of sales in 2021 and declining to around 18% by 2023

- Dividend growth of 4% per year through to 2023

Key Recovery Rating Assumptions:

With low leverage, recovery prospects of Batelco's senior unsecured debt are good, assuming a distressed enterprise value (EV)/EBITDA multiple of 5.5x is used to calculate the post-reorganisation valuation.

Fitch calculates the recovery prospects for Batelco's senior unsecured debt at 100%, but the Recovery Rating is capped at 'RR4'/50% by country risk considerations.

RATING SENSITIVITIES

Batelco

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- 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.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Negative rating action on the sovereign.

- Pressure on FCF driven by EBITDA margin erosion, consistently higher capex and shareholder distributions, or significant under-performance in the core domestic market and at other key subsidiaries may be negative for the SCP but not necessarily the IDR.

- FFO net leverage sustained above 4.5x with failure to deleverage below such a threshold within the next 18 months may put pressure on the SCP but not necessarily the IDR.

Bahrain Sovereign

The main factors that could, individually or collectively, lead to positive rating action/upgrade are:

- Public Finances: Confidence in a narrowing of the budget deficit and a firm downward path in government debt/GDP over the medium term from a projected peak of around 133%, reducing the potential need for an expanded GCC financing package beyond 2023 and causing the removal of the -1

QO notch for Public Finances.

- Structural Features: A marked reduction in domestic and regional political risks or greater evidence of weaker socio-political constraints on fiscal policy, allowing for deeper reforms to use GDP per capita for generating more substantial diversified revenue and causing the removal of the -1 QO notch.

The main factors that could, individually or collectively, lead to negative rating action/downgrade:

-Public Finances: Further significant deterioration of public debt dynamics, or increased financing constraints including a weakening of financial support from GCC partners.

-External Finances: Signs of lessening GCC support which could place greater pressure on the balance of payments and currency peg and lead to the removal of the +1 notch on External Finances.

-Structural: Severe deterioration of the domestic security environment that hits economic performance and hinders fiscal reform implementation.

Best/Worst Case Rating Scenario

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

Liquidity and Debt Structure

Adequate Liquidity: At end-2020 Batelco had BHD195.3 million of cash on its balance sheet, and BHD7.2 million of Bahrain sovereign bonds with next maturities in 2022 and 2023.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Bahrain Telecommunications Company	LT IDR	B+	Affirmed		B+
• senior unsecured	LT	B+	Affirmed	RR4	B+

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		

RATINGS KEY	OUTLOOK	WATCH
EVOLVING	○	◆
STABLE	○	

Applicable Criteria

Corporate Rating Criteria (pub.21 Dec 2020) (including rating assumption sensitivity)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub.09 Apr 2021) (including rating assumption sensitivity)

Country-Specific Treatment of Recovery Ratings Criteria (pub.05 Jan 2021)

Government-Related Entities Rating Criteria (pub.30 Sep 2020)

Parent and Subsidiary Linkage Rating Criteria (pub.26 Aug 2020)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

Bahrain Telecommunications Company	UK Issued, EU Endorsed

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