Fitch Upgrades P4 to 'BB'; Outlook Stable

Fitch Ratings - London - 11 October 2018: Fitch Ratings has upgraded P4 S.p. Z.o.o 's (P4 or Play) Long-Term Issuer Default Rating (IDR) to 'BB' from 'BB-' . The Outlook is Stable.

The upgrade reflects P4's strong underlying operating profile including its leading market share - by revenue and subscribers - in Poland's mobile market, a competitive but largely rational market structure, solid cash flow and the stability of the company's balance sheet and financial policy following its initial public offering (IPO) in 2017. While fixed-mobile convergence has developed some commercial traction for fixed incumbent, Orange, Poland is so far proving to be a market where a mobile-only strategy can be successful. This view is underlined by P4's ascendance from market challenger to market leader in a matter of years and the strength of financial results.

Fitch has reset the company's rating leverage thresholds reflecting a shift in the business's operating profile and inherently more disciplined financial structure following the IPO. Our rating case envisages funds from operations (FFO) net leverage of 4.1x at YE18 below the 'BB' threshold of 4.2x. A forecast metric sustained below this level supports the upgrade.

RATING ACTIONS

ENTITY	RATING		PRIOR
P4 Sp. z o.o.	Natl LT BBB(pol) Upgrade		BBB-(pol)
	LT IDR BB Upgrade		BB-

KEY RATING DRIVERS

Market Leadership, Cash Flow: P4's credit profile is underpinned by its consistently strong operating performance, solid cash flow and established financial policy. These factors are fundamental to a reset of the rating sensitivities and the upgrade. In a short number of years the company has become the market leader, from the market's number four and a mobile challenger A maturing mobile market and competition are likely to temper future growth. A clear financial strategy is accompanied by cash flows which should support deleveraging.

Financial Policy, Balance Sheet De-risked: In Fitch's view, the IPO in 2017 has materially de-risked the balance sheet. While under private equity ownership, Fitch believed there was always a risk of a re-leveraging event, either in the form of a dividend recap or as was the case in 2017, by refinancing a holdco PIK within the restricted borrower group. Public ownership and financial policy including target net debt to adjusted EBITDA of around 2.5x, along with management's track record of delivering results, support our expectations of a disciplined approach to the balance sheet.

Rating Sensitivities Reset: Fitch previously set P4's rating sensitivities (upgrade/ downgrade thresholds) taking into account the company's operational status as the market challenger; along with the re-leveraging risk attendant in its private equity ownership and the PIK structure/instrument that

had existed outside the restricted group. With both factors ameliorated following the IPO, Fitch has updated its leverage based sensitivities, bringing them into line with single country operator peers such as Italy's WIND Tre (B+/Stable) and Switzerland's Sunrise (BB+/Stable).

The FFO net leverage threshold at 'BB+' is now set at below 3.7x and at 'BB' below 4.2x. P4 ended 2017 with leverage of 3.3x. Our rating case predicts a metric of 4.1x at YE18, with deleveraging envisaged in subsequent years. These levels are reflected in the upgrade to 'BB'.

Mobile Only Strategy: P4 has successfully pursued a mobile only strategy, despite the market presence of fixed-mobile convergent offers - most notably from fixed incumbent, Orange. Fitch believes the strategy is sustainable given the country's low fixed line broadband penetration, fragmented fixed line competition and the presence of four technologically developed data networks in a competitive mobile market. Improving fibre roll-out is being met by demand for ultrahigh-speed fixed broadband. Mobile voice and data is by far the dominant market bundle.

Market, Company Maturation: Mobile penetration now exceeds 140% in Poland, with active subscriber numbers now contracting a little. Absolute growth has therefore gone from the market with a competitive four player mobile network operator market focused on migrating subscribers to postpaid tariffs, up-selling larger data packages and adding service bundles. Play has a good track record of improving its subscriber mix, which has helped sustain market leading average revenues per user. Its rural strategy should deliver further subscriber additions. Growth across the market will inevitably be harder to find.

Network Expansion: Play has chosen to expand its mobile network into the rural parts of the country and is targeting an additional one to two million subscribers. In Fitch's view, service quality, easily understood tariff structures and network quality are the commercial factors that have driven Play's success this far. In an increasingly mature market Play will need to rely ever more on these qualities if it is to achieve this target by winning customers from the market, given that subscriber market growth is now unlikely. Play is already carrying close to 95% of traffic on its own network (5.5% of 2017 traffic via national roaming) while LTE coverage stood at 93.4% at YE17.

Potential Cash Flow Pressures: Management has successfully maintained low capital intensity rates. Its medium-term target is for capex to sales of around 8%, with an additional PLN500 million budgeted to complete the rural build-out. Fitch assumes a capital intensity rate of 11% for 2018-2020. Network expansion has the scope to pressure capital intensity targets, while at some point 5G spectrum will become available, with past experience proving spectrum is an expensive commodity in Poland. Forecast deleveraging will depend on discipline in both areas.

DERIVATION SUMMARY

Play compares favourably with a peer group that includes smaller, single-country telecom operators such as Telefonica Deutschland (BBB/Positive), Sunrise Communications, WIND Tre and eir (B+/Stable), as well as the leveraged cable sector. Compared with its peer group, Play exhibits solid operating metrics and strong financials - particularly in terms of revenue growth and underlying cash flow strength. The business exhibits a deleveraging capacity that is not present in many of its telecom peers and is more analogous to its cable sector peers in this regard. In Fitch's view, the IPO in 2017 has removed the risk of any further holdco PIK issuance or dividend recaps. The balance sheet has been materially de-risked and rating thresholds brought in line with its closest peers, Sunrise and WIND Tre.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer:
- Revenue is expected to grow at low single digits in all years from 2018 to 2021
- EBITDA margin is expected to decline in 2018 to 32.0% following pressures from international roaming regulation changes introduced in 2017. Thereafter the margin is expected to increase to

33.5% by 2021
- Capital expenditure as a percentage of sales increasing to 11.5% in 2018 and remaining at that level until 2021 when it is expected to fall to 8.0%
- Dividends paid in 2018 of PLN 652 million. Dividend policy in 2019 to 2021 expected to be up to 50% of free cash flow to equity
- We assume the mandatory amortisations in the senior facilities are to be partially refinanced with additional debt in all years to 2021

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action
- Continued strong subscriber metrics and an ongoing shift in the subscriber mix to post-paid, with subscriber acquisition cost and post-paid churn close to management's expectations.
- A financial policy that is likely to result in FFO-adjusted net leverage managed at or below 3.7x, a level consistent with net debt/EBITDA of around 3.0x, which would result in an upgrade to 'BB+'.

Developments That May, Individually or Collectively, Lead to Negative Rating Action
- A more intense competitive environment, pressuring revenue and profitability. An expectation that convergent services are deemed by the market to be a more important offering could also create negative rating pressure.
- A financial policy or weakened financial performance leading to FFO-adjusted net leverage consistently above 4.2x, which would result in a downgrade to 'BB-'.
Fixed charge cover consistently below 3.3x, would result in a downgrade.
Post dividend free cash flow margin consistently below mid-single digits

LIQUIDITY AND DEBT STRUCTURE

Reasonable Liquidity: We expect the company to generate negative free cash flow in 2018 following a decline in the EBITDA margin and the payment of a PLN652 million dividend in the first half of the year. Thereafter we expect free cash flow margins to return to positive mid-single digits following EBTIDA margin gains and management's 2Q18 dividend policy revision to up to 50% of free cash flow to equity from 65% to 75%.

The company signed a senior facilities agreement in March 2017, which included a mandatorily amortising facility of PLN 2.4 billion. The repayments are structured sothat 16% (PLN391 million) of the principal is repaid in 2018 and 24% (PLN586 million) per year thereafter to March 2022. Our conservative forecasts assume the company will be able to service these payments through a mixture of existing liquidity, by drawing down on the PLN400 million revolving credit facilities and through additional borrowing.

SUMMARY OF FINANCIAL STATEMENT ADJUSTMENTS

Fitch has adjusted the December 2017 financial statements to move a total of PLN515 million into non-recurring cash flows, which are excluded from FFO. The PLN515 million consists of:
- PLN170 million non-recurring interest payments following the refinancing in March 2017
- PLN283 million non-recurring employee incentive scheme settlements
- PLN62 million IPO related costs

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Applicable Criteria

Corporate Rating Criteria (pub. 23 Mar 2018) (/site/re/10023785)
Sector Navigators (pub. 23 Mar 2018) (/site/re/10023790)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form (/site/dodd-frank-disclosure/10048055)
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