Milano, 15 novembre 2022 – Tim rende noto che in data odierna l'agenzia di rating Fitch ha modificato il giudizio di rating da livello BB *outlook negative a livello BB- outlook negative*.

Allegato il giudizio dell'agenzia di rating

FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades Telecom Italia to 'BB-', Outlook Negative

Tue 15 Nov, 2022 - 3:45 PM ET

Fitch Ratings - Milan - 15 Nov 2022: Fitch Ratings has downgraded Telecom Italia S.p.A's (TI) Long-Term Issuer Default Rating (IDR) to 'BB-' from 'BB'. The Outlook on the IDR is Negative. Fitch has also downgraded the senior unsecured instrument rating to 'BB-' from 'BB', with a recovery rating of 'RR4'.

The rating downgrade reflects the absence of sufficient debt reduction in 2022. Fitch expects TI's EBITDA net leverage to exceed 4.5x from 2023, which is a threshold to maintain a 'BB' rating. The worsening macroeconomic environment adds execution risks on the company's growth and deleveraging capacity.

The Negative Outlook reflects the lower liquidity and interest coverage ratios, which are moving towards a 'B+' rating profile. Significant investment outlay and sustained negative free cash flow (FCF) at a time of strong market competition, increasing inflation and high interest rates result in lower cash reserves and liquidity metrics.

Fitch continues to base TI's rating on its current operating scope, which includes its fixed network assets. There is still uncertainty on the execution of TI's strategic options to optimise the value of its businesses and strengthen its competitive position. Any impact on TI's rating and credit profile would depend on the details of any proposed transaction structure and the subsequent reallocation of debt.

KEY RATING DRIVERS

Leverage Increasing, Negative FCF: Fitch's base-case forecasts assume that TI's EBITDA net leverage will increase to about 4.7x at end-2023 from 4.3x at end-2022 before declining to about 4.6x by end-2024. We also expect TI's FCF to remain negative for at least three years - our definition of FCF does not include the expected funds TI should receive from the PNRR (the EU-funded recovery and resilience plan) of about EUR600m and EUR500m in 2024 and 2025, respectively. TI's financing of its negative FCF is increasingly important given the backdrop of volatile financial markets and high interest rates.

The increase in leverage is driven by a weak EBITDA profile, higher interest and one-off payments, including EUR2.1 billion of spectrum costs in 2022. We expect Fitch-defined EBITDA to decrease to EUR5 billion in 2022 from EUR5.3 billion in 2021. Continued losses of high-margin wholesale revenue are likely to have a disproportionate effect on the group EBITDA margin, increasing the execution risk to TI's efforts to stabilise its EBITDA through cost-cutting measures.

Large Debt Refinancing: The refinancing of TI's upcoming maturities and maintenance of sufficient liquidity will become increasingly important. TI has debt maturities of EUR3.4 billion and EUR4.5 billion in 2023 and 2024 respectively.

We estimate that the company will have cash reserves of about EUR4.7 billion and undrawn credit facilities of about EUR4 billion at end-2022, which would allow it to cover its upcoming debt maturities until June 2024, but at the expense of exhausting its liquidity. Fitch expects TI's EBITDA interest coverage ratio to fall below 3.0x in 2023 from 3.2x in 2022.

Cost Reductions Define Leverage Trajectory: The pace at which TI is able to offset the competitive pressure on revenue and margin through cost reduction is uncertain and dependent on strong execution. Fitch expects improvements in leverage in 2024, driven by lower content and operational costs, and CPI-linked revenue, when the EBITDA margin will start to increase. Management now aims to reduce the cost base in Italy of EUR4.8 billion by 20% in 2024, up from a previously announced 15%.

TI realised 90% of its 2022 savings target of EUR300 million in 9M22, but not enough to increase EBITDA in 2022. While these efficiencies will pass through to 2023 and should continue to increase, we expect them to be offset by stronger competitive and inflationary pressures increasing in 2023. This will result in the Fitch-defined EBITDA margin reducing to 31.8% in 2023 from 32.4% in 2022.

Worsening Macroeconomic Environment: In its September 2022 Global Economic Outlook, Fitch lowered its growth forecasts for Italy in 2022. It now believes the economy will contract in 2023 as a result of the energy shock. This will directly affect production and consumer purchasing power. Italy is one of the most gas-reliant EU states, with gas generating 50% of its electricity, compared with 20% in the EU as whole. CPI inflation is expected to be 8.5% in 2022, up from 4.2% in 2021, before reducing to 3.3% in 2023.

We expect higher inflation and lower consumer purchasing power will affect TI's EBITDA and its revenue. The company has hedged 75% of their energy costs for 2023, but higher costs could still offset some cost efficiencies realised from its transformational plan. For example, tower-rental lease costs are CPI-linked, adding to TI's lease expenses in 2023 and reducing its EBITDA margin. Lower consumer purchasing power increases the execution risk of TI's customer base stabilisation as it establishes its competitive positioning as the "value over volume" brand operator.

Strong Market Position to Remain: Competitive pressures in the mobile and fixed wholesale segments have continued as rivals Iliad Italy builds scale and Open Fiber continues to expand its network. Despite these pressures, TI's market position remains strong. While TI will cede some market share in the next two to three years, we expect it to retain its leading position. TI is the market leader in fixed broadband and mobile with shares of about 41% and 28.5%, respectively.

TI continues to lead in the B2B segment with above market growth in its Enterprise business. Over the past year, competition in mobile has started to slow as Iliad reaches scale, but competition in fixed has increased, leading to TI's fixed broadband market share (retail + wholesale) falling to 80.7% in 2Q22 from 83.4% in 2Q21.

Extraordinary Transactions Uncertainty: TI has outlined two strategic options to reduce its debt. One option was to divest its network assets or its enterprise division but the expected timing of this remains uncertain. TI had said that it favoured a second option, a merger between its network assets and Open Fiber, but this has entailed lengthy negotiations given the multitude of stakeholders. Even if the stakeholders reach an agreement, the regulatory scrutiny for the merger would be significant, which could delay the transaction further.

TI is subject to the Golden Power rule as a strategic asset and the volatility in Italian politics and recent change in government has led to further delays. For example, the terms of a memorandum of understanding (MOU) signed between TI, Cassa depositi e prestiti SpA (BBB/Stable), Open Fiber, Macquarie Fund and KKR in May have been extended.

DERIVATION SUMMARY

TI's ratings are driven by its strong domestic position, with leading market shares, underpinned by a leading network footprint in Italy but high leverage. TI's reduced ownership in its local access network, despite retaining control, slightly weakens its operating profile compared with other western European incumbent telecom operators that fully own their local access network.

TI's leverage thresholds are looser than similarly rated cable peers, such as VMED O2 UK Limited and Telenet Group Holding N.V (both 'BB-'/Stable), and on a par with those of higher-rated BT Group plc (BBB/Stable). The latter fully owns its local access networks but faces FCF volatility from pension deficits and the competitive environment. Like TI, Royal KPN N.V.'s (BBB/Stable) revenue mix has a domestic focus, but it has ownership of a majority of its entire local access network. BT and Royal KPN's higher ratings reflect their lower leverage.

Other higher-rated peers, such as Deutsche Telekom AG and Orange S.A. (both 'BBB+'/Stable), have greater diversification, as well as lower leverage and greater organic deleveraging capacity.

KEY ASSUMPTIONS

- Domestic revenue to decline by 5.7% and 3.0% in 2022 and 2023, respectively, before stabilising, with group revenue broadly flat in 2022-2024.

- Company-defined EBITDA margin (before special factors and leases) of 38.8% in 2022, reducing to 38.6% in 2023, before increasing slightly to 38.9% in 2024.

- Recurring cash tax payments of EUR90 million-EUR150 million a year in 2022-2024.

- Broadly stable working-capital requirements over the next two years, before increasing to EUR75 million in 2024.

- Capex (excluding spectrum) at 26% of revenue in 2022 and 2023, and 23% in 2024.

- No dividends in 2022-2024, including savings shares.

- Net outflow of EUR500 million from a reduction in TI's holding of INWIT and partial purchase of Oi assets in Brazil (the Oi asset purchase is assumed to be consolidated for six months in 2022, which is within Fitch's base-case assumptions).

- Inflow of PNRR funds of EUR600 million in 2024 and EUR500m in 2025, aiding net debt reduction.

RATING SENSITIVITIES

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

- Funds from operations (FFO) net leverage sustained below 5.0x (equivalent to about 4.5x Fitch-defined EBITDA net leverage). Fitch will also be guided by TI's FFO net leverage on a proportionate basis for FiberCop.

- A sustained improvement in domestic operations and fixed and mobile operations that stabilises EBITDA and improves organic deleveraging capacity.

- FFO interest coverage sustainably over 3.5x (with EBITDA interest coverage above 4.0x).

- The Outlook could be changed to Stable if TI improves its liquidity profile with higher-than-expected EBITDA, stronger FCF and successful debt refinancing.

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

- FFO net leverage sustained above 5.7x (equivalent to about 5.2x Fitch-defined EBITDA net leverage). Fitch will also be guided by TI's FFO net leverage on a proportionate basis for FiberCop.

- Tangible worsening of operating conditions or the regulatory environment, leading to expectations of materially weaker FCF generation.

- Sustained competitive pressure in the mobile, fixed and wholesale segments, driving significant losses in service revenue market share.

- Decreasing liquidity and signs of reduced access to financial markets for refinancing.

- FFO interest coverage sustainably below 2.5x (with EBITDA interest coverage decreasing below 3.0x).

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

Weakening Liquidity: TI's liquidity profile is defined by its EUR5 billion of cash and equivalents at end-3Q22 and EUR4 billion of available undrawn credit facilities, with which the company can cover its operating and financing obligations until June 2024. TI has upcoming debt maturities of a combined EUR7.9 billion up to 2024. Coupled with negative FCF, this results in weak liquidity metrics.

ISSUER PROFILE

TI is the incumbent telecom carrier in Italy, with leading market positions in both fixed-line and mobile. The company owns 67% of TIM Brazil, the third-largest mobile operator in Brazil.

SUMMARY OF FINANCIAL ADJUSTMENTS

One-off goodwill clean-up payments included as a non-recurring payment EUR231 million made in 2021 was added back to cash flow operations and expensed in non-recurring items.

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

TI has and ESG Relevance score of '4' for Governance Structure. This reflects historic conflicts between TI's shareholders and frequent changes to senior management. This has a negative impact on the credit profile and is relevant to the ratings in conjunction with other factors.

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.

RATING ACTIONS

ENTITY / DEBT ⬍	RATING ⬍	RECOVERY ⬍	PRIOR ⬍

Telecom Italia Capital					
senior unsecured	LT	BB-	Downgrade	RR4	BB
Telecom Italia S.p.A.	LT IDR	BB- Rating Outlook Negative	Downgrade		BB Rating Outlook Negative
senior unsecured	LT	BB-	Downgrade	RR4	BB
Telecom Italia Finance SA					
senior unsecured	LT	BB-	Downgrade	RR4	BB

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

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

Sector Navigators: Addendum to the Corporate Rating Criteria (pub. 28 Oct 2022)

Corporate Rating Criteria (pub. 28 Oct 2022) (including rating assumption sensitivity)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Telecom Italia Capital	EU Issued, UK Endorsed
Telecom Italia Finance SA	EU Issued, UK Endorsed
Telecom Italia S.p.A.	EU Issued, UK Endorsed

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