

Rating Action: Moody's downgrades Telecom Italia's ratings to Ba2; outlook negative

10 Dec 2020

Madrid, December 10, 2020 -- Moody's Investors Service ("Moody's") has today downgraded the corporate family rating (CFR) and the ratings of all debt instruments issued (or guaranteed) by Telecom Italia S.p.A. (Telecom Italia) and its subsidiaries to Ba2/(P)Ba2 from Ba1/(P)Ba1. Concurrently, Moody's has downgraded to Ba2-PD from Ba1-PD the company's probability of default rating (PDR). The outlook is negative.

A full list of affected ratings is provided towards the end of this press release.

"The downgrade reflects our expectation that Telecom Italia will remain adversely affected by a very competitive operating environment in Italy which will further constrain the company's ability to strengthen cash flow generation and reduce leverage," says Carlos Winzer, a Moody's Senior Vice President and lead analyst for Telecom Italia.

"In addition, we expect further investments in Brazil together with the restored dividend policy and the increasing complexity of the group structure to translate into higher business and financial risks. We expect the company's net adjusted leverage to peak at 4.2x in 2020 and improve towards 3.7x by 2022, exceeding the 3.5x maximum leverage tolerance for the previous rating," adds Mr. Winzer.

RATINGS RATIONALE

The downgrade of Telecom Italia's ratings to Ba2 from Ba1 reflects the combination of three main factors: (1) the challenging operating environment both in the fixed and mobile telecommunications segments in Italy, which will continue to put pressure on group revenues and cash flow generation, (2) the increasing complexity of the group structure as Telecom Italia dilutes its equity ownership in key infrastructure assets such as FiberCop S.p.A. (58% ownership) and INWIT (17.2%), and (3) the more aggressive financial policy associated with the 2020 decisions to resume dividend distributions to ordinary shareholders and to consider additional investments in Oi in Brazil, all of which translate into higher leverage no longer commensurate with a Ba1 rating. Moody's regards the increased group complexity and more aggressive financial policy as a governance risk under its ESG framework.

Moody's expects that, despite recently reported improvement in domestic key performance indicators both in fixed and mobile, the operating environment for Telecom Italia will remain challenging, with around 1.5% revenue decrease in 2021 and the expectation of reaching revenue stability only by 2022. Telecom Italia's service revenues have been severely affected by the entry of Iliad in the Italian market in 2018. YoY Q3 2020 reported revenues and EBITDA have declined by 12% and 18%, respectively (-5% and -7.9% organic, like-for-like), owing to the intense competitive domestic market and the impact from foreign currency volatility in its Brazilian operations, adding to the deconsolidation of INWIT. Moody's notes, however, that both mobile and fixed pricing in Italy have been marginally improving in recent months, easing some pressure in the domestic business, and that Sky's entrance in fixed broadband has not had an impact on the market so far. However, the competitive intensity may resume in the fixed broadband segment when Iliad launches its fixed offer expected by mid-2021.

Moody's also notes management's efforts and success in executing Telecom Italia's strategy, which was designed two years ago and included a plan to enhance the quality of both fixed and mobile networks, further improve cash flow by reinforcing cost cutting, accelerating customer satisfaction and additional convergent services to support future revenue growth.

The rating downgrade also reflects the increasing corporate complexity of the group which, in Moody's view, complicates the analysis of credit metrics relative to some peers and implies a higher business risk.

Moody's notes the completion of the merger of Telecom Italia and Vodafone Italy's towers into INWIT creating a deconsolidated Joint Venture in which Telecom Italia only owns a 17.2% equity stake, with additional minority shareholders, as well as the separation of Telecom Italia's secondary network with the creation of FiberCop, alongside the sale of a 37.5% stake to KKR and a 4.5% stake to Fastweb. Although the company will raise

approximately €4 billion in cash to reduce debt as a result of these sales, it is diluting its stakes in key infrastructure assets which benefit from a more predictable cash flow generation capacity than service operations. In addition, the company fully consolidates assets that it does not fully own, including TIM Brasil (66.58%) and FiberCop (58%). Moody's estimates that TI's 2020 leverage on a pro rata consolidated basis would be 0.3x higher than leverage reported on a fully consolidated basis.

Moody's expects Telecom Italia's adjusted net debt/EBITDA to peak at 4.2x in 2020 and thereafter to improve towards 3.7x by 2022. The restored dividend payout together with additional investments in Brazil, and continued high capex needs in Italy will constrain the company's free cash flow and therefore its ability to de-lever over the next 24 months.

In calculating free cash flow for H1 2020 (most recent auditor reviewed financial statements), Moody's has reduced cash inflow from operating activities (CFO) by €516 million to €3,514 million. This adjustment has been made because the financing activities section of the cash flow statement contains an outflow of €516 million described as "changes in hedging and non-hedging derivatives" which, in Moody's opinion, does not reflect an outflow of cash. Moody's adjusted CFO of €3,514 million is €581 million higher than EBITDA of €3,398 million reported for H1 2020, after adding back €465 million to CFO for income taxes paid, net interest paid and dividends received.

The Ba2 rating reflects Telecom Italia's: (1) scale and position as the incumbent service provider in Italy, with strong market shares in both fixed and mobile segments; (2) international diversification in Brazil; and (3) strong operating margins and continued focus on cost control.

Counterbalancing these strengths are: (1) high competitive pressures in Italy; (2) expectations of continued revenue declines through 2022; (3) high net leverage; and (4) continued need for capex investments which have restricted cash flow and its ability to de-lever.

LIQUIDITY

Moody's considers Telecom Italia's liquidity position to be strong, based on the company's cash flow generation, available cash resources and committed credit lines, as well as an extended debt maturity profile. The company has ample access to liquidity as a result of (1) its current cash and marketable securities position of around €3.9 billion; and (2) its €6.7 billion committed credit facility that expires in January 2023. These liquidity sources cover the company's debt maturities over the next 18 to 24 months. Moody's notes that in 2022, the company faces larger than average debt maturities of €4.9 billion, which Moody's expects will be refinanced well ahead of maturity, as well as the payment of €1.7 billion worth of spectrum.

RATIONALE FOR NEGATIVE OUTLOOK

The negative outlook reflects Telecom Italia's high leverage peaking at 4.2x in 2020 with only marginal improvement to around 4x in 2021. Despite early signs of improvements, visibility still remains low in relation to a more marked improvement in the currently weak operating performance.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Negative pressure could be exerted on Telecom Italia's rating in the event of (1) a material decline in its organic operating performance relative to Moody's expectations, including low single digit decline in revenues in 2021 with stable EBITDA, trending towards revenue stability with some EBITDA growth in 2022; or (2) failure to achieve a deleveraging trajectory, particularly if the company's net adjusted debt/EBITDA remains above 3.75x by 2022, with no prospect of improvement. In addition, downward pressure would also be exerted on the rating if concerns about the strength of the group's liquidity arise.

Conversely, Moody's could consider a rating upgrade if Telecom Italia's operating performance materially improves and exceeds the rating agency's expectations, such that its net adjusted debt/EBITDA remains comfortably below 3.25x on a sustained basis.

As part of the rating action, Moody's has tightened the leverage parameters for the rating by 0.25x to reflect the increased complexity of the group structure following the recent transactions involving INWIT and FiberCop.

LIST OF AFFECTED RATINGS

..Issuer: Olivetti Finance N.V.

Downgrade:

...Backed Senior Unsecured Regular Bond/Debenture, Downgraded to Ba2 from Ba1

Outlook Action:

....Outlook, Remains Negative

..Issuer: Telecom Italia Capital S.A.

Downgrade:

...Backed Senior Unsecured Regular Bond/Debenture, Downgraded to Ba2 from Ba1

Outlook action:

....Outlook, Remains Negative

..Issuer: Telecom Italia Finance, S.A.

Downgrades:

...Backed Senior Unsecured Medium-Term Note Program, Downgraded to (P)Ba2 from (P)Ba1

...Backed Senior Unsecured Regular Bond/Debenture, Downgraded to Ba2 from Ba1

Outlook action:

....Outlook, Remains Negative

..Issuer: Telecom Italia S.p.A.

Downgrades:

....Probability of Default Rating, Downgraded to Ba2-PD from Ba1-PD

...LT Corporate Family Rating, Downgraded to Ba2 from Ba1

...Senior Unsecured Medium-Term Note Program, Downgraded to (P)Ba2 from (P)Ba1

...Senior Unsecured Bank Credit Facility, Downgraded to Ba2 from Ba1

...Backed Senior Unsecured Medium-Term Note Program, Downgraded to (P)Ba2 from (P)Ba1

...Senior Unsecured Regular Bond/Debenture, Downgraded to Ba2 from Ba1

Outlook Action:

....Outlook, Remains Negative

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Telecommunications Service Providers published in January 2017 and available at http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1055812. Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

COMPANY PROFILE

Telecom Italia Group (consisting of Telecom Italia S.p.A. and its subsidiaries) is the leading integrated telecommunications provider in Italy. The company delivers a full range of services and products, including telephony, data exchange, interactive content, and information and communications technology solutions. In addition, the group is one of the leading telecom companies in the Brazilian mobile market, operating through its subsidiary TIM Brasil. Vivendi SA (Baa2, Stable) and Cassa Depositi e Prestiti S.p.A. (Baa3, Stable) are the main shareholders in Telecom Italia, with 23.9% and 9.9% equity stakes, respectively. In 2019, Telecom Italia reported €18 billion in revenue and €8 billion in EBITDA, respectively.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moody's.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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