

Milano, 23 marzo 2022 – Tim rende noto che in data odierna l'agenzia di rating S&P Global Ratings ha modificato il giudizio di rating da livello BB+/B con outlook stabile a livello BB- outlook negative.

Allegato il giudizio dell'agenzia di rating

Research Update:

Telecom Italia SpA Downgraded To 'BB-' On Weaker Credit Ratios And Financial Prospects; Outlook Negative

March 23, 2022

Rating Action Overview

- In contrast to our previous forecast for adjusted debt to EBITDA of less than 4.5x for Telecom Italia SpA in 2021-2022, we now expect lower revenue and earnings and negative free operating cash flow (FOCF) after leases will cause our adjusted leverage metrics to remain above our 4.5x threshold for the 'BB' rating.
- The weaker performance and guidance are due to year-on-year domestic revenue and EBITDA declining faster than anticipated, a slower recovery of roaming and handset sales, and adverse currency movements that are still affecting contributions from the Brazil business in 2021.
- We now anticipate a low-single-digit-percent decline in total revenues in 2022--versus a stabilization in our previous forecasts--and a drop in adjusted EBITDA margin toward 37%-38%, versus about 40% in 2021. It results in S&P Global Ratings-adjusted leverage of about 5.3x in 2022, improving toward 5.0x in 2023.
- Therefore, we lowered our long-term rating on Telecom Italia to 'BB-' from 'BB'.
- The negative outlook reflects that we could lower our ratings to 'B+' if leverage remains elevated at more than 5.0x over a prolonged period due to more-negative-than-anticipated reported FOCF after leases.

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Rating Action Rationale

In 2021, sharper-than-expected EBITDA decline and slightly higher capital expenditures (capex) resulted in an S&P Global Ratings-adjusted debt to EBITDA of 4.6x, above our rating trigger for the 'BB' rating. In 2021, Telecom Italia (TIM) fell short of our expectations in terms of adjusted EBITDA that landed at about €6.0 billion, versus our previous forecast of €6.6 billion, resulting in a 16%-17% year-on-year decline. This is the result of continued fierce competition in the Italian mobile and fixed-line markets. Although some operational trends are improving--for instance, subscriber base reduction is slowing down and the churn rate is falling--fixed and

mobile revenues continue to decline, largely due to reduced interconnection tariffs and lower average revenue per user (ARPU). What's more, TIM's earnings have been impaired by weaker-than-expected benefits from DAZN sports rights and a delay in voucher subsidies that further pressured the group's ARPU. Finally, higher-than-expected costs associated with football broadcasting, the launch of some digital companies (fueling revenue growth, but at a lower margin than the more traditional telecom activities), and corporate reorganization and restructuring further pressure Italian operations and earnings. In Brazil, the negative foreign exchange (FX) movements on Reis' contributions, although lessening, have more than offset organic growth in 2021. Weaker adjusted EBITDA, combined with higher-than-planned capital expenditures--to fund the acceleration of fiber-to-the-home (FTTH) deployment, investment in cloud business and football in Italy, as well as preparation for the integration of Oi Mobile in Brazil--translated into negative reported FOCF of almost €550 million in 2021, from about €2.1 billion positive in 2020 and adjusted leverage of 4.6x, which exceeds our maximum leverage threshold for the 'BB' rating.

We expect adjusted leverage will temporarily peak in 2022, at nearly 5.3x, then return to about 5.0x. In contrast to our previous forecast that credit metrics for TIM would improve from 2022, we now expect S&P Global Ratings-adjusted debt to EBITDA will peak at 5.2x-5.3x in 2022, then strengthen towards 5.0x in 2023. In 2022, we now forecast low-single-digit-percent adjusted revenue decline, compared to a stabilization in our previous base case. Competitive market environment, accentuated further by the recent launch of Iliad's fixed offers, as well as regulatory constraints will likely continue to weigh on TIM's domestic revenues and EBITDA. What's more, following new law (DL 207/2021) TIM is changing its offers for consumer and microbusiness resulting in front-end loaded costs, which will hurt EBITDA in 2022, fading away in following years. This is partly offset by positive impact from vouchers--although less than expected due to stricter rules, positive impact should start accruing from 2022--and our forecast of about 10% organic service revenue and annual EBITDA growth rate in Brazil, combined with less-unfavorable FX movements from 2022. Capex to sales will remain elevated in 2022 at 26%-27% and one-off cash outflows associated to the acquisition of Oi Mobile in Brazil (about €1.2 billion) and 5G spectrum in Italy and Brazil (about €2.1 billion) will further weigh on TIM's adjusted leverage in 2022 that we forecast at 5.2x-5.3x, with negative reported FOCF of about €735 million. In 2023, planned EBITDA recovery (although still below 2021 level), combined with lessening capex intensity toward 24%-26% of sales, should translate into still negative but improving reported FOCF after lease of about €275 million, and adjusted leverage still high but strengthening toward 5.0x, which corresponds to the maximum leverage authorized at the current rating.

Our forecasts incorporate the pro forma effects of the recently announced sale of additional stakes in Daphne 3--which owns 30.2% of INWIT--that has yet to close. We include the incremental sale of tower ownership to a consortium of investors led by Ardian for about €1.5 billion (including the unlocking of cash in a vendor loan). Although not finalized yet, we believe the transaction is likely to close as the offer from the group of investors is binding and TIM's board of directors gave its approval to carry over the negotiations. Although this transaction will reduce net debt because of the proceeds, our offsetting adjustment for leases would partly offset the benefits. However, we calculate a 0.2x positive impact on the group's adjusted leverage from the transaction.

We have not yet incorporated in our forecasts KKR's offer to take TIM private, nor TIM's strategic stand-alone reorganization plan. On March 14, 2022, TIM's board of directors mandated the CEO and chairman of the group to begin formal talks with U.S. private equity fund KKR regarding its nonbinding and indicative offer on the entire share capital of the company. We

still do not consider the take-private transaction in our base-case scenario for TIM because the offer is nonbinding, the Italian government may block the transaction if it deemed it not in the national interest, and TIM also presented on March 3 its strategic plan to reorganize its activities on its own, also considering a possible merger with Open Fiber, to which TIM's board of directors remains supportive. TIM's strategic plan to separate its activities into a ServiceCo and a NetCo does not constitute our base case for the group as we have no visibility on the structure of such a transaction (we understand the group will provide guidance on these new entities at the capital market day) and TIM continues to guide on the combined group. An asset-light ServiceCo could erode TIM's incumbent advantage and credit profile compared with fully integrated European telecom peers, if not balanced by deleveraging or improvements in the network and the structure of the broader fiber wholesale market through a potential combination of OpenFiber and TIM's fixed-line assets. However, we acknowledge a structural separation would provide regulatory relief to both the ServiceCo and the NetCo. Ultimately, the capital structure of NetCo and ServiceCo, as well as the terms of any agreement for ServiceCo to access a fixed network, would be critical to understand the financial impact of the proposed structural subordination.

Outlook

The negative outlook is based on our forecast that debt to EBITDA will be elevated at about 5.3x in 2022, and fall close to 5.0x in 2023. However, operational and investment risks could keep leverage higher for longer, which could trigger a downgrade.

Downside scenario

We could lower the rating if we forecast adjusted leverage staying substantially above 5.0x on a prolonged period. This could stem from a return to unsustainable mobile competition that further depresses the ARPU or causes a spike in customer attrition, or from longer term fixed-line deterioration under wholesale pressure from Open Fiber and retail pressure from Iliad. More leverage could also stem from more negative reported FOCF than currently forecast in our base case. If, contrary to our current expectations, Telecom Italia moved to relinquish control over its fixed network, we could also consider a downgrade based on a weaker business profile, unless this was offset by a material reduction in leverage.

Upside scenario

We could stabilize the rating if we expect sustainable adjusted leverage comfortably below 5.0x, combined with FOCF to debt improving toward 5% or above.

Company Description

Telecom Italia (TIM) is the incumbent telecom operator in Italy and the market leader in voice and data services on fixed-line and mobile networks for retail and wholesale operators. As of Dec. 31, 2021, the company had about 8.6 million fixed-line retail customers and about 30.5 million wireless customers in Italy. It also has operations in Brazil through its 66.7% stake in TIM Participações S.A. (TIM Brazil). For the full-year 2021, Italy contributed about 82% and Brazil 18% to the group's revenue.

Our Base-Case Scenario

Assumptions

- Italian GDP will grow by 3.3% and 1.6% in 2022 and 2023, respectively. Brazilian GDP will grow by 0.4% in 2022 and 1.5% in 2023. We also assume 5.5% inflation in Italy, and 8.6% inflation in Brazil, over 2022.
- The group's total reported revenue (fully consolidating FiberCop) and service revenue--when fully consolidating FiberCop--to decline by 1%-2% year-on-year on a like-for-like basis in 2022, affected by intense competition in the Italian fixed and mobile market, paired with lower-than-expected DAZN contribution and vouchers delayed, although partly offset by growing contribution from the Brazilian unit.
- From 2023, 0%-2% growth on increased broadband customers, in particular with ultra-broadband, assuming no major disruption from the recent entrance of a new fixed broadband player.
- Organic revenue growth of 5%-7% in Brazil in 2022 and 2023, mainly supported by the continuous recovery of the prepaid and postpaid segments, and fixed telephony services growth supported by TIM Live as the company expects to add more high-speed connections, further boosting the broadband business. From 2022, we expect the negative FX impact to recede to about 1%, leading to reported revenue growth of about 4% in 2022 and 4%-5% in 2023, supported by continuing organic performance.
- Reported EBITDA (fully consolidating FiberCop) to decrease by a low-double-digit percentage compared to 2021 organic reported EBITDA of €6,223 million. On an adjusted basis (pro rata consolidating FiberCo, among other adjustments), we expect the EBITDA margin will decline to 37%-38%, from about 40% in 2021. This is spurred by provisions related to the DAZN deal, football and digital companies startup costs, a mix change toward lower-margin nontelecom business, and continued competitive market further pressuring margins. This is partly offset by high reported EBITDA margin of 48%-49% in Brazil. We expect the group's efficiency program will lead to group-adjusted EBITDA margin steadily recovering toward 38%-39% in 2023.
- High capex of about €4 billion in 2022, declining to €3.9 billion in 2023. This reflects plans to further develop fiber (FTTC/FTTH) networks in Italy, strengthen the mobile ultra-broadband infrastructure, and develop 5G in Brazil. The capex also includes DAZN-related expenditure for the distribution of the Serie A championship.
- Cash outflow of €1.18 billion related to the acquisition of Oi Mobile assets in Brazil.
- Cash outflow of €2.1 billion related to the 5G frequencies in Italy and Brazil.
- Proceeds of €1.3 billion-€1.5 billion related to the highly likely sale of 41% stake in Daphne 3, which holds 30.2% stake in INWIT, to a consortium of investors led by Ardian.
- No dividends to shareholders.

Key metrics

Telecom Italia SpA--Key Metrics*

Mil. €	--Fiscal year ended Dec. 31--				
	2020a	2021a	2022e	2023f	2024f
Revenue	16	15.1	14.8-15.0	15.0-15.2	15.4-15.6
Revenue growth (%)	(12)	(6)	(2)-0	0-2	2-3
EBITDA	7.2	6	5.4-5.6	5.7-5.9	6.0-6.2
EBITDA margin (%)	44.9	39.8	37-38	38-39	39-40
Funds from operations (FFO)	6.1	4.5	3.8-4.0	4.1-4.3	4.5-4.7
Capital expenditure	3.5	3.6	3.4-3.6	3.2-3.4	3.1-3.3
Free operating cash flow (FOCF)	3.2	1.3	0.6-0.8	1.2-1.4	1.6-1.8
Debt	30.4	27.8	29.3-29.5	29.2-29.4	28.8-29.0
Debt to EBITDA (x)	4.2	4.6	5.2-5.3	c. 5.0	4.6-4.7
FFO to debt (%)	20.1	16.4	12.5-13.5	14-15	15.5-16.5
FOCF to debt (%)	10.5	4.7	0-1	2-3	3-4

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

Liquidity

We assess Telecom Italia's liquidity as adequate. This reflects our view that the group's sources of liquidity cover its uses of liquidity by more than 1.2x over the next 12 months started Jan. 1, 2022.

Principal liquidity sources:

In our base-case forecast, we estimate Telecom Italia's liquidity sources at about €16.8 billion over the next 12 months. These include:

- Available cash balances of about €9.3 billion;
- Available undrawn bank lines about €4.0 billion; and
- Funds from operations of €3.5 billion-€3.6 billion.

Principal liquidity uses:

We estimate Telecom Italia's liquidity needs over the next 12 months at about €11.8 billion. These include:

- Debt maturities of about €4.5 billion;
- Annual capex requirements of roughly €4.0 billion;
- Acquisitions of about €1.18 billion (part of Oi mobile business); and
- Spectrum outflows of about €2.1 billion.

Environmental, Social, And Governance

ESG credit indicators: To E-2, S-3, G-3; From E-2, S-3, G-2

Governance factors are now a moderately negative consideration in our credit rating analysis, reflecting the recent multiple profit warnings that weighed on the group's results in 2021, as well as on its short- and mid-term guidance, resulting in spiking leverage and deteriorating reported FOCF after leases toward negative territory. It also factors in uncertainties around the evolution of the group's strategic direction as TIM has presented its plan for a potential split of its activities between a NetCo and a ServiceCo, while announcing a few days later that it is starting formal discussion with KKR on its nonbinding offer to take the company private. Social factors continue to be a moderately negative consideration in our credit rating analysis of TIM, reflecting exposure to political and regulatory decision-making affecting its operations or strategic decisions.

Issue Ratings - Recovery Analysis

Key analytical factors

- The recovery rating of '3' is unchanged on all the senior unsecured debt obligations based on indicative recovery prospects of 50%. However, we lowered the issue rating to 'BB-' from 'BB', in line with the issuer credit rating. The recovery rating is supported by the limited amount of prior-ranking debt but constrained by the large amount of unsecured debt.
- Our hypothetical default scenario assumes that increased competition in domestic fixed-line wholesale business and increased wireless competition will hamper Telecom Italia's earnings and profitability.
- We value Telecom Italia as a going concern considering its strong market position in Italy as the country's incumbent telecom operator.

Simulated default assumptions

- Year of default: 2026
- Minimum capex (share of last three years' average sales): 6%
- Operational adjustment: 40% (reflecting additional minimal capex required to maintain the networks)
- EBITDA at emergence after recovery adjustments: €3,170.9 million
- Implied enterprise value multiple: 6.0x
- Jurisdiction: Italy

Simplified waterfall

- Gross enterprise value at default: €18,369.5 million
- Administrative costs: 5%
- Net value available to creditors: €17,451 million

- Priority claims: €1,537.8 million
- Senior unsecured debt claims: €30,115.4 million* ^
- Recovery expectations: (rounded to nearest 5%): 50% (recovery rating: 3)

*All debt amounts include six months of prepetition interest. ^Includes €4.0 billion revolving credit facility drawn at 85%.

Ratings Score Snapshot

Issuer Credit Rating: BB-/Negative/B

Business risk: Satisfactory

- Country risk: Moderately high
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Aggressive

- Cash flow/Leverage: Aggressive

Anchor: bb

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: Negative (-1 notch)

Environmental, social, and governance (ESG) credit factors for this change in credit rating/outlook and/or CreditWatch status:

- Risk management, culture, and oversight

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate

Issuers, Dec. 7, 2016

- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Downgraded; Outlook Action

	To	From
Telecom Italia SpA		
Issuer Credit Rating	BB-/Negative/B	BB/Stable/B
Senior Unsecured	BB-	BB
Recovery Rating	3(50%)	3(55%)
Telecom Italia Capital S.A.		
Senior Unsecured	BB-	BB
Recovery Rating	3(50%)	3(55%)
Telecom Italia Finance S.A.		
Senior Unsecured	BB-	BB
Recovery Rating	3(50%)	3(55%)

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceld/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914

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