Fitch Affirms Deutsche Telekom at 'BBB+'; Outlook Stable

Fitch Ratings - Frankfurt am Main - 17 Aug 2021: Fitch Ratings has affirmed Deutsche Telekom AG's (DT) Long-Term Issuer Default Rating (IDR) and senior unsecured rating at 'BBB+'. The Long-Term IDR is on Stable Outlook. The affirmation also applies to the debt issued by Deutsche Telekom International Finance B.V. and guaranteed by DT.

The ratings of DT reflect its leading position in its domestic market and a diversified portfolio of international assets, which includes T-Mobile US (TMUS; BBB-/Stable), the third- and second-largest mobile operator in the US by revenue and subscribers, respectively.

Fitch's assessment of DT's key credit metrics focuses on the company's European operations and considers TMUS on both deconsolidated and proportionate consolidated bases, reflecting DT's minority interest in the business. On this basis, DT is comfortably positioned within its 'BBB+' rating while retaining modest leverage headroom. EBITDA growth in its domestic market and Europe is likely to reduce the impact on free cash flow (FCF) from higher capex due to fibre and 5G network deployments.

Key Rating Drivers

Leading Position in Germany: DT has a strong position in its domestic market with an estimated 33% service revenue share in the mobile market and an estimated 56% subscriber share in the broadband market. DT operates across consumer, business and wholesale segments while owning incumbent fixed and mobile networks that enable the deployment of its convergent strategy. This optimises economies of scale and is reflected in the company's 21% operating FCF margins (EBITDA after leases less capex), which we expect will remain broadly stable over the next three to four years.

Medium-Term Domestic Risks Manageable: The German telecoms market comprises two nationwide fixed-line operators and three mobile-telecoms operators. The deployment of a fourth mobile network by Drillisch is unlikely to significantly destabilise the market structure given its existing mobile customer base. However, speed- and data-monetisation opportunities that drive average revenue per user (ARPU) improvement could be hit in the medium term by greater alternative wholesale fixed-line availability and Drillisch's need to improve network utilisation.

Fibre Strategy Trade-offs: DT intends to roll out 10 million fibre-to-the-home (FttH) lines in Germany by 2024 or approximately 23% of total households. DT expects full national coverage by 2030, of which 60%-70% will directly be deployed by the company and the remainder through third parties or partnerships. While this helps DT manage regulatory pressure and reduce investment risks and
moderate capex, it may hit EBITDA in the medium-to-long term as the company loses wholesale margin on the product. Visibility on the extent to which this may happen is low, but a significant reduction in EBITDA could weaken the company's operating profile.

US Merger on Track, FCF Growth: TMUS is making strong progress on extracting synergies from its merger with Sprint. The company is also gaining market share and building scale that is supporting EBITDA growth. Merger integration costs and capex levels are likely to remain high over the next three years, restraining FCF generation. As these expenses wind down, FCF generation should grow strongly. TMUS has indicated that it may buy back USD60 billion of its own shares in 2023-2025. The share buyback will help DT lift its ownership in TMUS from its current 43%. If required, DT has in place call options to take its holding to 50.1% by 2024 to retain voting control.

Deconsolidated and Proportionate Rating Profile: DT currently retains control of TMUS as a result of its agreement with fellow shareholder Softbank. This allows DT to consolidate TMUS on an accounting basis. Fitch believes the best way to quantitatively assess the company's ability to meet its debt obligations is to consider the cash-generation capacity of its European operations excluding TMUS or on a proportionate basis. This reflects a combination of factors, which include DT's minority holding in TMUS, weak legal ties, limited operational ties with parent DT, an intended standalone funding structure for TMUS and voting control that will not provide DT with sufficient cash fungibility between itself and TMUS.

Strong Remaining European Profile: Following the deconsolidation of DT's US operations, the credit profile of DT would be anchored around its domestic operations, which would account for about 61% of total EBITDA (excluding TMUS or 36% on proportionate basis of its economic holding in TMUS). DT's other European operations and group functions account for the remaining proportion. The company retains strong geographic diversification and well-positioned, convergent operators in other European markets that allow DT to respect its leverage thresholds on both deconsolidated and proportionate bases.

Small Leverage Headroom: We estimate DT's FFO net leverage at end-2020 at 3.0x, assuming the deconsolidation of TMUS. We expect this will remain broadly stable over the next three to four years, reflecting a low organic deleveraging capacity. We expect growth in deconsolidated EBITDA as growing service revenues, cost reductions and reducing impact from special factors are partly offset by increasing capex for FttH and 5G network deployment. Potential assets sales e.g. T-Mobile Netherlands, are not part of our base case, but could provide options in managing financial flexibility, if needed.

Derivation Summary

DT has a strong operating profile that is driven by a combination of a leading domestic position in Germany and the growing scale and FCF of TMUS following its merger with Sprint. The company is rated in line with that of other western European diversified telecoms operators with similar strong domestic operations and a geographically diversified portfolio of international businesses such as Orange SA (BBB+ / Stable), Vodafone Group Plc. (BBB / Stable) and Telefonica SA (BBB / Stable). The combination of a strong domestic position and diversified businesses portfolio enables slightly higher
leverage capacity for the ratings compared with operators with limited scale such as BT Group Plc (BBB / Stable) and Royal KPN NV (BBB / Stable). No country-ceiling, parent / subsidiary or operating environment aspects affect the ratings.

Key Assumptions

Fitch's Key Assumptions within our Rating Case for the Issuer

- Revenue growth, excluding TMUS, of 0% to 1% per year between 2021 and 2024
- TMUS's revenue growth of 8.5% in 2021, 2.4% in 2022 and 2% per year between 2023 and 2024
- EBITDA margin, excluding TMUS (after operating leases and special factors), of 32% in 2021 and gradually increasing to above 33% by 2024
- TMUS's EBITDA margin (after operating and capital leases and special factors excluding proceeds from handset lease revenues) of 27% in 2021, gradually increasing to 35% by 2024
- Total cash tax of EUR960 million in 2021, growing to EUR1.2 billion by 2024 (about 25%-27% is related to TMUS)
- Capex, excluding TMUS, of EUR7.8 billion in 2021, gradually increasing to EUR8.2 billion by 2024
- Capex at TMUS of EUR10.2 billion in 2021, gradually decreasing to EUR8.5 billion by 2024
- Share buyback at TMUS of EUR12.5 billion in 2023 and 2024
- TMUS's repayment of EUR2 billion of inter-company debt in 2022 to DT
- Constant USD/EUR exchange rate of 0.84 to 2024

RATING SENSITIVITIES

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

- FFO net leverage on a deconsolidated or a proportionate basis for TMUS sustained below 2.3x (2020: deconsolidated 3.0x and proportionate 3.1x).
- Improved visibility on the impact to EBITDA from the partial deployment of DT's FttH network in Germany.
- Strong operating profile at TMUS with continued self-financing capability.

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

- An increase in FFO net leverage on a deconsolidated and / or a proportionate basis for TMUS to above 3.3x on a sustained basis. Spikes in leverage may be consistent with the current ratings if the company has a credible plan to reduce leverage within 18-24 months.
- 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.

**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**

Robust Liquidity, Well-Spread Maturities: DT's policy is to maintain a liquidity buffer sufficient to cover 24 months of debt maturities. At end-2020, DT had liquidity reserves of EUR17 billion, excluding TMUS, comprising EUR4.5 billion cash and cash equivalents and EUR12.6 billion undrawn committed credit facilities versus EUR7.9 billion maturities to end-2022.

**Summary of Financial Adjustments**

- Adjustments for de-recognition of leased handsets and outstanding handset receivables related to financial-services operations (assessed using a debt-to-equity ratio of 4x) resulted in a reduction of the level of debt used in calculating our leverage metrics by around EUR6.2 billion and a reduction in EBITDA of EUR1.5 billion per year.

**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

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**RATINGS KEY**

**OUTLOOK**

POSITIVE  
NEGATIVE  
Evolving  
STABLE  

**WATCH**

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**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)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 30 Apr 2021)

**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**

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Endorsement Status

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