28 October 2020 Corporates

Magyar Telekom Nyrt
Hungary, Telecommunication services

SCOPE BBB+ STABLE

Corporate profile

Magyar Telekom is Hungary's largest telecommunications operator with consolidated revenues of HUF 667bn (EUR 2.0bn) in 2019. It is the market leader with a customer base of 5.4m mobile clients, 1.4m fixed voice customers, and 1.3m broadband customers. It was created in 1989 as successor of the telecommunications company of Hungarian Post when that was split into three, under the usual name of Matav (short for Magyar Tavkozlesi RT), and was privatized in 1993 through a partial sale to a consortium including Deutsche Telekom, which now controls Magyar Telekom with 59% of its capital. Its only significant foreign subsidiary is Makedonski Telekom, the incumbent operator in North Macedonia.

Key metrics

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
EBITDA/interest cover	12.2x	15.9x	13.1x	12.2x
Scope-adjusted debt (SaD)/EBITDA	1.9x	1.6x	1.9x	1.7x
Scope-adjusted funds from operations/SaD	44%	53%	45%	50%
Free operating cash flow/SaD	20%	16%	0%	19%

Rating rationale

Scope Ratings has assigned an issuer credit rating of BBB+/Stable to Hungarian Magyar Telekom Nyrt. Scope has also assigned a BBB+ rating to senior unsecured debt.

The business risk profile (BBB+) benefits mainly from the low cyclicality in the telecom industry and the company's leading position in mobile and broadband markets in Hungary, which strongly support its competitive position. As the Hungarian telecommunications market is mature, we do not expect a significant change in market share. The group also displays stable profitability (29.6% EBITDA margin after leases in 2019), somewhat below that of main European peers. The group also benefits from a very strong position in North Macedonia.

Magyar Telekom's financial risk profile (A-) is sustained by the Scope-adjusted debt (SaD)/EBITDA ratio of below 2x. The group also benefits from good debt protection, with an EBITDA/Interest cover of well above 10x. We expect the group's debt to increase somewhat in 2020, mainly driven by the 5G auctions in Hungary, which took place in March (HUF 91bn, of which HUF 54bn paid in 2020) and will again take place in 2021 (to be paid in 2022) with the renewal of spectrum auctions in Hungary. Nevertheless, we expect SaD/EBITDA to remain below 2.0x. We assume that the Covid-19 crisis will have a limited impact on the group, as demonstrated by H1 2020 results. We view the liquidity of Magyar Telekom as adequate, in particular through its financial integration in the Deutsche Telekom group.

Financially, Magyar Telekom is strongly integrated in the Deutsche Telekom group (cash pooling, financing). While Deutsche Telekom is more indebted, we deem it a remote risk that the parent company's behaviour would adversely affect Magyar Telekom's ability to meet contractual financial debt obligations as a going concern on time and in full.

Magyar Telekom plans to issue up to HUF 70bn senior unsecured corporate bond under the Bond Funding for Growth Scheme of the Hungarian National Bank during Q4 2020 or Q1 2021. The bond will have a seven-year tenor, with 50% amortization at the end of the 6th year and we expect 2.5% of interest costs in our base case. The bond's proceeds will be used for general capex (networks, spectrum).

We rate senior unsecured debt at BBB+, the same level as the issuer rating.

Ratings & Outlook

Corporate rating	BBB+/Stable
Senior unsecured rating	BBB+

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Related Methodology

Corporate Rating Methodology, February 2020

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Outlook and rating-change drivers

The Stable Outlook incorporates assumptions of increased leverage, due to spectrum auctions in Hungary in 2020 and 2021.

A positive rating action is possible if deleveraging happened faster than expected, with SaD/EBITDA reaching below 1.5x on a sustained basis.

A negative rating action is possible in case of higher dividends, higher capex (spectrum), leading to a significant increase in leverage towards 3.0x on a sustained basis.

Rating drivers

Positive rating drivers	Negative rating drivers
• Leader in Hungarian mobile market, with a 45% share • Market leader in broadband in Hungary, with a 40% share • SaD/EBITDA ratio of below 2x • Market leader in North Macedonia, with a mobile market share of 50% • Large, diversified customer base	• Dependence on one market (Hungary) • Temporary increase in leverage with spectrum auctions • Profitability somewhat lower than European peer levels

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Lower leverage, with SaD/EBITDA of lower than 1.5x on a sustained basis	• Increased leverage, with SaD/EBITDA of towards 3.0x on a sustained basis

Financial overview

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
EBITDA/interest cover	12.2x	15.9x	13.1x	12.2x
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Scope-adjusted funds from operations/SaD	44%	53%	45%	50%
Free operating cash flow/SaD	20%	16%	0%	19%
Scope-adjusted EBITDA in HUF[1] m	**2018**	**2019**	**2020F**	**2021F**
EBITDA	192,507	220,562	217,650	225,400
Operating lease payments in respective year	11,501	0	0	0
Scope-adjusted EBITDA	204,008	220,562	217,650	225,400
Scope-adjusted funds from operations in HUF m	**2018**	**2019**	**2020F**	**2021F**
EBITDA	192,507	220,562	217,650	225,400
less: (net) cash interest as per cash flow statement	-18,498	-22,578	-22,000	-25,000
less: cash tax paid as per cash flow statement	-11,953	-12,560	-11,000	-11,700
add: depreciation component, operating leases	7,784	0	0	0
Scope-adjusted funds from operations	170,375	185,866	185,050	189,150
Scope-adjusted debt in HUF m	**2018**	**2019**	**2020F**	**2021F**
Reported gross financial debt	234,493	322,313	347,313	307,313
less: cash and cash equivalents	-7,204	-13,398	-12,788	-22,278
add: operating lease obligations	113,713	0	0	0
Other	46,115	42,744	78,000	93,500
Scope-adjusted debt	387,117	351,659	412,525	378,535

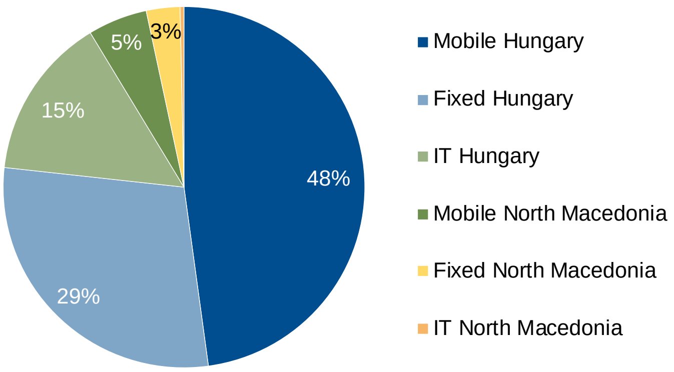
[1] EUR 1 = HUF 356 (October 2020)

Business risk profile

Industry risk profile: A

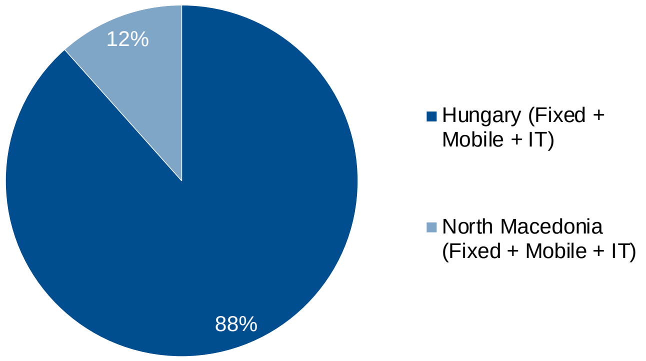
The industry risk profile for telecommunication services stands at A, based on low cyclicality (subscriptions for what is now considered a basic service), medium to high entry barriers (licences, network roll-out), and medium to low substitution (over-the-top services).

Figure 1: Magyar Telekom, revenues in 2019 (HUF 667bn)



Source: Magyar Telekom

Figure 2: Magyar Telekom, EBITDA after leases in 2019 (HUF 198bn)



Source: Magyar Telekom

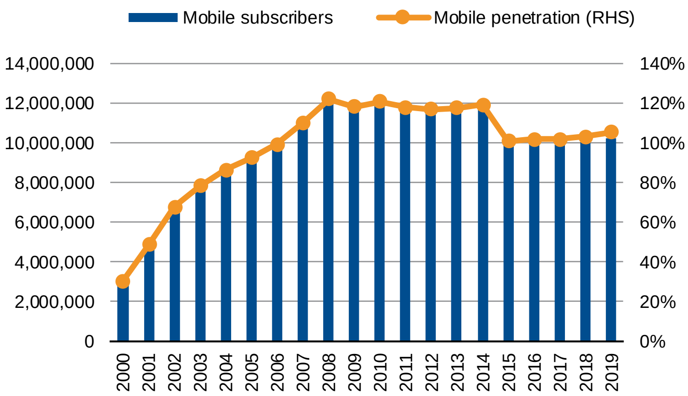
Market leader in Hungary

The group's home market of Hungary (9.7m inhabitants) represents 91% of its revenue. Magyar Telekom, as the incumbent operator, is the market leader. Its telecom revenues have continued to grow in recent years (up by around 3% in 2019; around 6% in 2018), driven by the mobile revenues and fixed-equipment sales, a situation not so common in Europe.

A very strong position in mobile

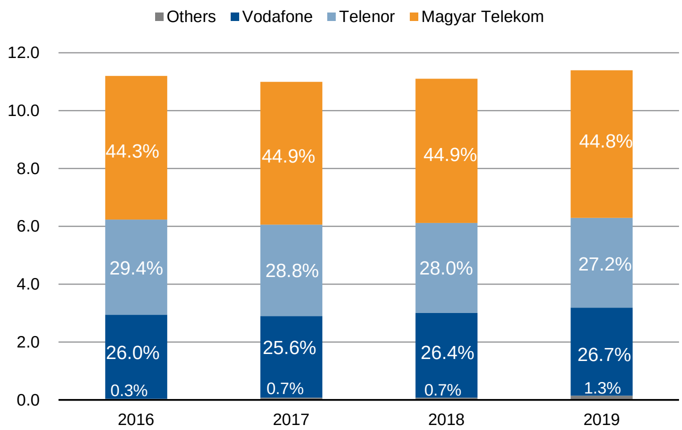
In Hungary, where mobile penetration is somewhat lower than in most European countries, the group is the clear leader with a market share around 45% (in terms of subscribers), a level which has remained remarkably stable and far above those of the two main competitors, Vodafone and Telenor-PPF. The group's market share in terms of revenue is 49% (Analysys Manson estimate), which is above the levels achieved by most market leaders in Europe.

Figure 3: Mobile subscribers and penetration in Hungary



Source: ITU, Scope estimates

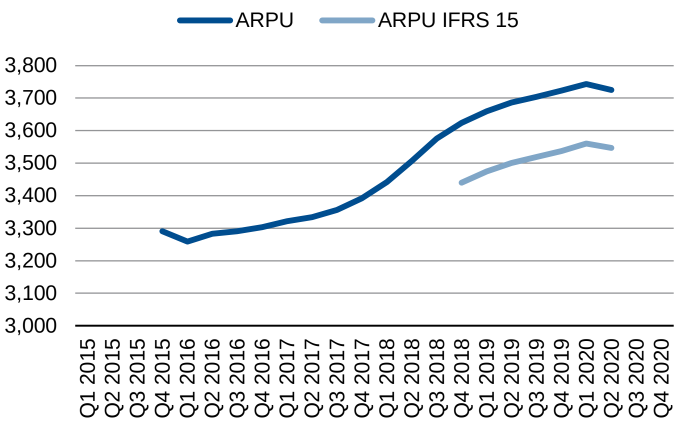
Figure 4: Mobile market share in Hungary (subscribers million)



Source: National Media and Infocommunications Authority (NMHH)

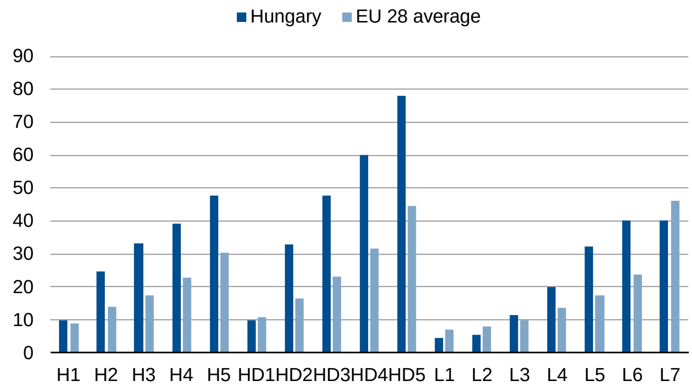
Hungary allocated 5G spectrum in April 2020 through auctions, and Magyar Telekom agreed to pay HUF 91bn (of which HUF 54bn in 2020), a reasonable price. This was helped by the regulator (NMHH) preventing Hungary's second largest fixed-service provider, DIGI, from bidding in the auction as it did not fulfill the requested conditions. As some spectrum renewal is expected in 2021, it seems DIGI will be unable to participate in the forthcoming auctions for similar reasons. Magyar Telekom's average revenue per user (ARPU) for mobile has been increasing over the last few years, a rare situation in Europe. According to the latest European Commission benchmark, Hungary is among the most expensive markets for mobile services.

Figure 5: Magyar Telekom mobile ARPU (HUF), 12-months rolling average



Source: Magyar Telekom, Scope

Figure 6: Mobile prices in Hungary vs EU average (EUR PPP) for 17 mobile baskets

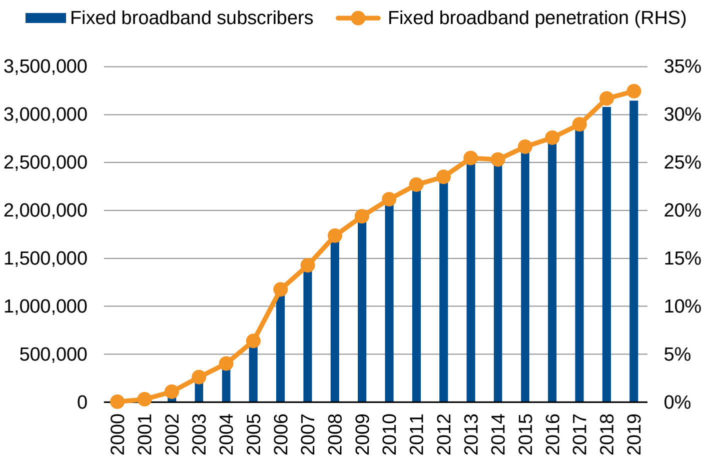


Source: European Commission, Scope

Hungary: strong position for cable

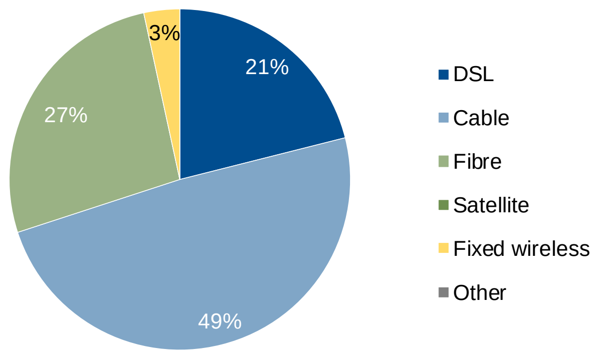
Magyar Telekom also has the leading position in fixed broadband in Hungary, where the market is still growing (by around 5% per year in terms of subscribers). Cable operators own much of Hungary's fixed-broadband market, which is unique in Europe. Even less common is that Magyar Telekom owns (and sometimes rents) a significant number of broadband access through cable technology.

Figure 7: Fixed broadband subscribers and penetration in Hungary



Source: ITU, Scope

Figure 8: Fixed broadband market by technology in Hungary (End 2019)

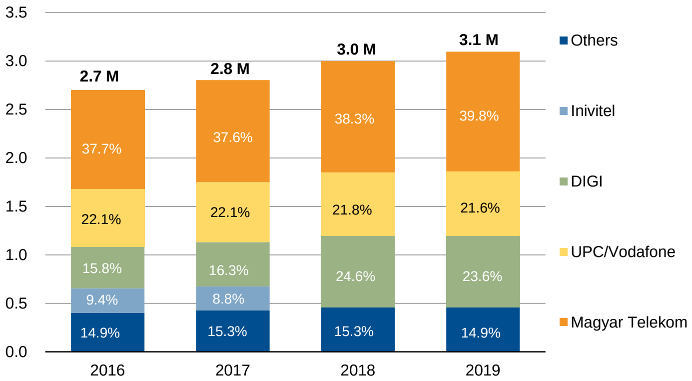


Source: OECD

40% market share through DSL, fibre and cable

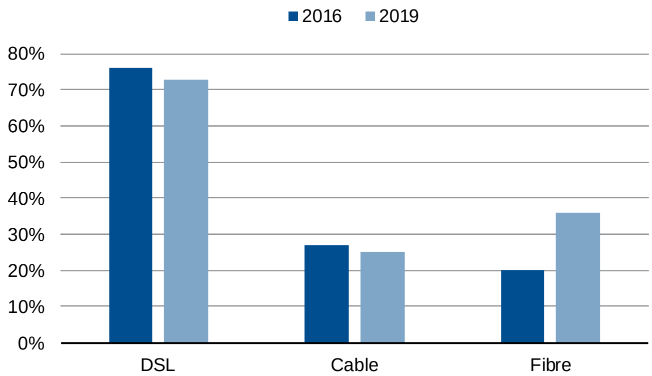
Magyar Telekom holds roughly 40% of Hungary's fixed-broadband market, a level in line with the average incumbent operator in Europe. In 2018, Vodafone became a key player in Hungarian fixed broadband through its acquisition of UPC. At about the same time, DIGI bought the smaller fixed service operator Invitel and became the second largest player in Hungary. Magyar Telekom's share of the broadband market has slowly but regularly increased in recent years, partly through the acquisition of smaller cable operators, but mostly through the roll-out of fibre (which now represents 28% of customers, vs 6% five years ago). Magyar Telekom's ARPU for broadband services was declining until 2014 but has now stabilised. Pricing for these services in Hungary are generally lower than the EU average.

Figure 9: Fixed broadband subscribers (million) and market shares (%) in Hungary



Source: Magyar Telekom

Figure 10: Magyar Telekom's market share in fixed broadband per technology (2016 and 2019)



Source: Magyar Telekom, OECD, Scope

In North Macedonia (2.1m inhabitants), Magyar Telekom's 51% subsidiary is the incumbent operator (still 35% owned by the government), with almost 50% of the mobile market and about 40% fixed-broadband subscribers.

Magyar Telekom is also the leading IT provider in Hungary's very fragmented market (through the T-Systems brand), with its market share estimated at 16%.

In terms of diversification, the group is almost entirely focused on telecommunications services in Hungary and, to much lower extent, in North Macedonia. The weight of IT services in group EBITDA is also rather limited. In terms of profitability, Magyar Telekom's margin (EBITDA margin after leases of 29.6% in 2019) is lower than for most European incumbents focused on domestic market, typically at around 40%.

Covid-19 impact very limited

According to H1 2020 results, the Covid-19 crisis has had a very limited impact on core business, and the group has maintained its guidance for both revenue and EBITDA.

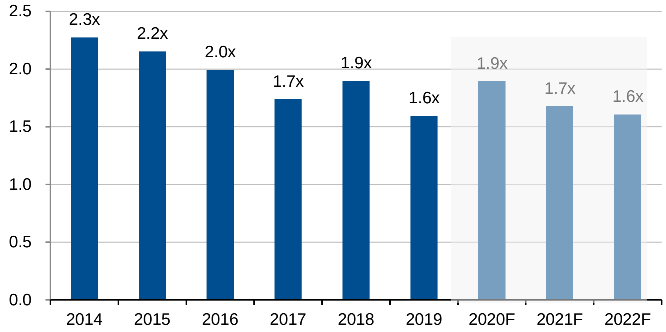
Financial risk profile

Debt set to increase in 2020 and 2022 due to spectrum auctions…

…but leverage and debt protection expected to remain good

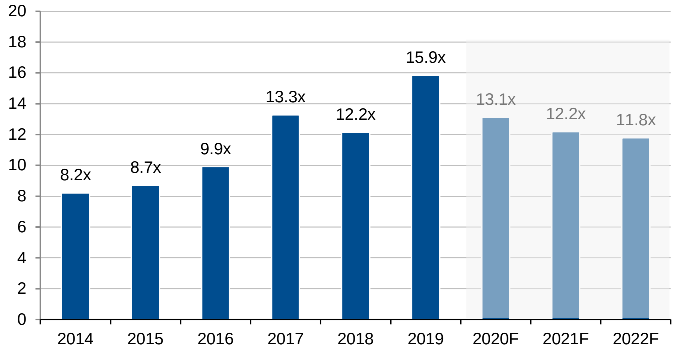
The main driver of debt in the coming years will be Magyar Telekom's investment in 5G spectrum in March 2020 (HUF 91bn for 700 MHz, 2,100 MHz and 3.5 GHz) and in forthcoming spectrum renewal auctions in 2021 (900 MHz and 1,800 MHz). Leverage stood at 1.6x at YE 2019 after declining in recent years. We expect leverage to increase slightly in 2020 and 2022 but remain below 2.0x. The group also benefits from good debt protection, which increased to 15.9x at YE 2019 after averaging 11.4x in recent years. We expect debt protection to lower somewhat following the spectrum investments, but remain above the average of previous years, and significantly above 7.0x.

Figure 11: Leverage, 2014-2022F



Source: Magyar Telekom, Scope estimates

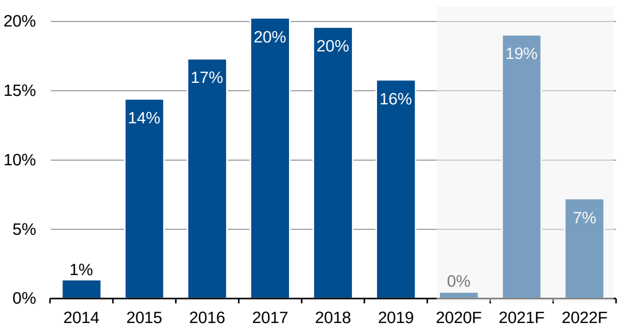
Figure 12: Debt protection, 2014-2022F



Source: Magyar Telekom, Scope estimates

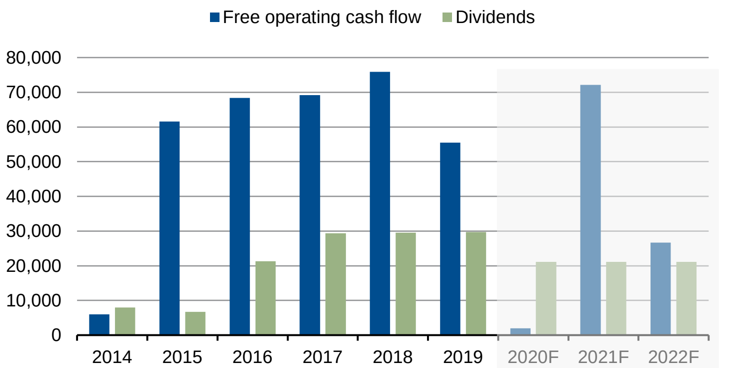
Over the last six years, the free operating cash flow/SaD ratio averaged 13.9% (with a peak of 20% in 2017 and 2018). Excluding the figure in 2014, when Magyar Telekom made spectrum investments, the average would be 16.9%. We expect the ratio to lower significantly in 2020 and 2022 due to spectrum investments and to stand at 19% in 2021. In 2019, Magyar Telekom decided ahead of the spectrum auctions to cut its dividend by 20%.

Figure 13: Free operating cash flow/SaD, 2014-2022F



Source: Magyar Telekom, Scope estimates

Figure 14: Free operating cash flow and dividends (HUFm), 2014-2022F



Source: Magyar Telekom, Scope estimates

Over the last six years, cash and undrawn committed lines have averaged 1.5x of short-term debt, with the level reaching 1.0x at the end of 2019. The issuer's parent company Deutsche Telekom, which has been providing all current and non-current financial liabilities at Magyar Telekom, is also providing adequate liquidity for its subsidiary.

Supplementary rating drivers

Link with parent company unlikely to affect credit quality

Although Magyar Telekom is strongly financially integrated into the Deutsche Telekom group (which owns 59% of the issuer) in terms of cash pooling and financing, we deem it a remote risk that the parent company's behaviour would adversely affect Magyar Telekom's credit quality in the foreseeable future. Deutsche Telekom's creditworthiness is driven by its strong position in mobile and broadband in Germany, its growing share of the US mobile market, and the increased leverage and execution risks accompanying its merger with Sprint, after which Deutsche Telekom's leverage has stayed at just above 3.0x. However, we do not consider that the parent group's credit risk profile to constrain Magyar Telekom's creditworthiness.

Long-term debt rating

Reflecting our view of Magyar Telekom's ability to meet contractual and financial debt obligations as a going concern, on time, and in full out of its operating business, we rate senior unsecured debt issued by the company at BBB+, the same level as the issuer rating.

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