



Fitch Ratings: New Spectrum Payment Terms Improve Telefonica Deutschland's Rating Headroom

Fitch Ratings-London-09 September 2019: Fitch Ratings says the new payment terms for 5G spectrum introduced by the Federal government will significantly improve Telefonica Deutschland's (TEF DE; BBB/Stable) leverage profile.

Previously Fitch had estimated that the spectrum payment of EUR1.3 billion in 2019 would increase TEF DE's funds from operations (FFO) adjusted net leverage by 0.5x to 2.7x in that year. The new terms imply payment in instalments over several years, which will remove immediate pressure on TEF DE's leverage and create substantial headroom at the current rating level.

TEF DE acquired 90MHz of spectrum in the 2.1GHz and 3.6GHz bands for a total consideration of EUR1.43 billion in June 2019, of which EUR1.26 billion were initially payable in 2H19 and the remaining EUR0.17 billion were due in 2024.

The improved terms of payment are offered to all spectrum auction winners in exchange for additional LTE network expansion commitments, including building sites in white spots and 99% LTE coverage by end-2021 per federal state. Fitch expects this to translate into additional capex in the next three years which, combined with a high dividend payout ratio, will likely lead to moderately increasing leverage at TEF DE, albeit comfortably below its downgrade threshold of 3.25x.

Fitch also expects competitive intensity in Germany to gradually increase in the medium-term as Drillisch builds out its network and emerges as the fourth network operator in the German mobile market following its participation in the 5G spectrum auction. The change in the payment terms will improve Drillisch's business case for which a payment of EUR1.1 billion for the spectrum is sizeable for the company's scale. The recent completion of the acquisition of cable operator Unitymedia by Vodafone is another factor contributing to increasing competition in the medium term.

The proposed changes in the payment terms, although generally positive, will not have a material impact on Deutsche Telekom AG's and Vodafone Group's leverage profiles due to their large scale.

See also "Germany 5G Auctions Spur Emergence of 4th Network Operator" for Fitch's expectations on Drillisch's emergence as the fourth mobile network operator and its impact on the German market at <https://www.fitchratings.com/site/pr/10079110>

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