

# מעלות על הבוקר

שוק התקשורת באירופה ובישראל



# **Standard & Poor's Corporate Ratings**

## **The European and Israeli Telecom Sectors – Similarities and Differences**

**Nov. 13, 2012**

**Patrice Cochelin, Analytical Manager EMEA Telecoms &  
Technology**

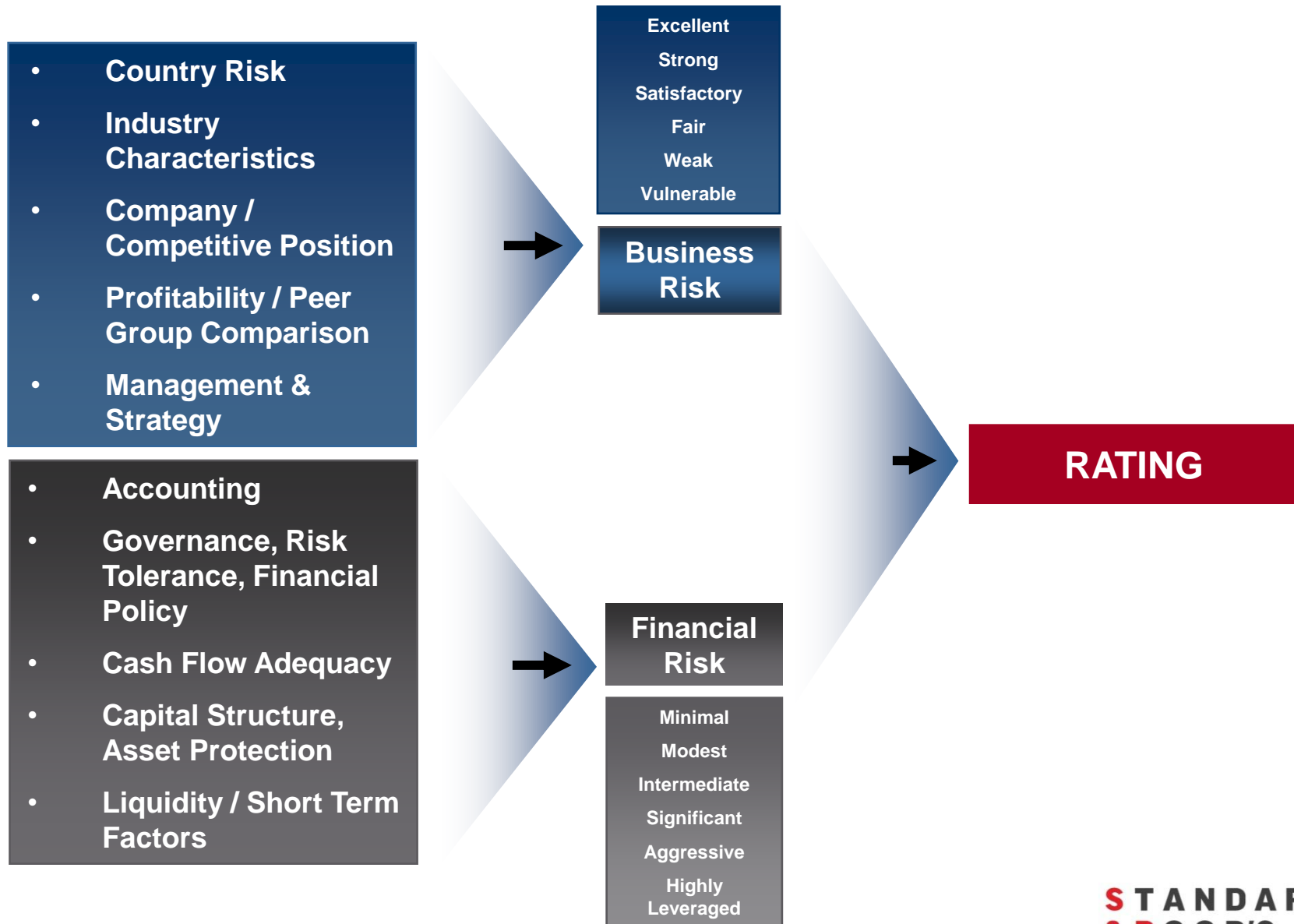
**Etai Rappel, Corporate and Infrastructure Analyst**

# Agenda

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- **Eurozone and Israel – General Outlook and Trends**
- **European Telecom Sector trends**
- **Israeli Telecom Sector**
- **Questions**

# Analytical Framework: Corporate Issuers



# Relationship Between Business And Financial Risk Profiles

## Business And Financial Risk Profile Matrix

Business Risk Profile	--Financial Risk Profile--					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly Leveraged
Excellent	AAA/AA+	AA	A	A-	BBB	--
Strong	AA	A	A-	BBB	BB	BB-
Satisfactory	A-	BBB+	BBB	BB+	BB-	B+
Fair	--	BBB-	BB+	BB	BB-	B
Weak	--	--	BB	BB-	B+	B-
Vulnerable	--	--	--	B+	B	B- or below

These rating outcomes are shown for guidance purposes only. Actual rating should be within one notch of indicated rating outcomes.



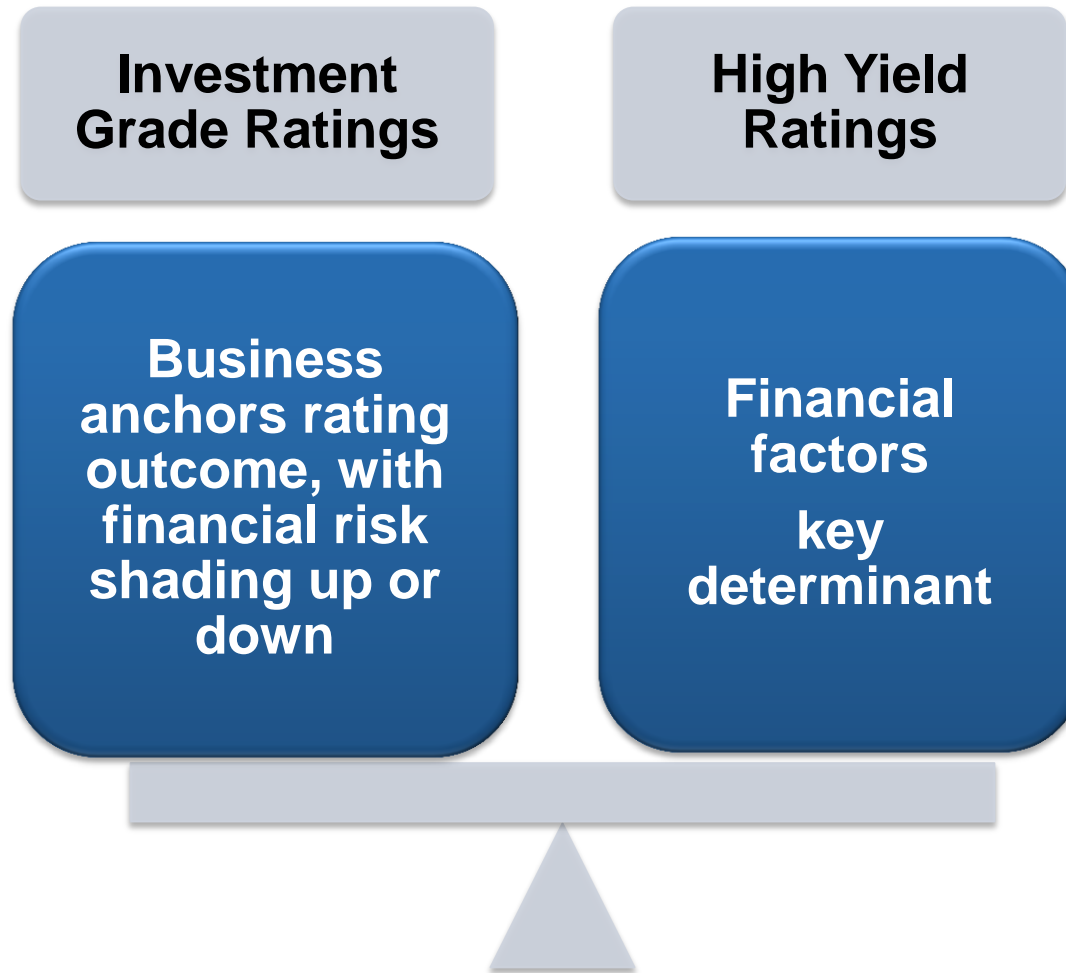
The ratings indicated in each cell of the matrix are the midpoints of a range of likely rating possibilities. This range would ordinarily span one notch above and below the indicated rating.

## Financial Risk Indicative Ratios (Corporates)

	FFO/Debt (%)	Debt/EBITDA (x)	Debt/Capital (%)
Minimal	greater than 60	less than 1.5	less than 25
Modest	45-60	1.5-2.0	25-35
Intermediate	30-45	2-3	35-45
Significant	20-30	3-4	45-50
Aggressive	12-20	4-5	50-60
Highly Leveraged	less than 12	greater than 5	greater than 60

# Linking of business risk to financial ratios

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Relative Weights of Business and Financial Factors Vary Through Spectrum

# The mapping table

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Standard & Poor's Maalot  
National scale ratings

Standard & Poor's  
Local currency global scale  
ratings

'iIAAA'

'iIAA'

'iIA'

'iIBBB'

'iIBB'

'iIB'

'iICCC'

'iICC'

'SD'

'D'

'BBB' and Higher

'BB' or 'BBB'

'B' or 'BB'

'B'

'CCC'

'CCC'

'CCC'

'CC'

'SD'

'D'

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# Eurozone and Israel Outlook

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# European Economic Outlook

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- The outlook for Europe continues to worsen - we now expect zero GDP growth for the eurozone in 2013.
- The growth gap between north and south remains acute and we expect even deeper contractions in Italy and Spain than we anticipated a month ago.
- Germany remains the bright point, but even here there is pressure and we have trimmed our 2013 GDP forecast to +1.2% from +1.4%.
- If there is some good news it is that we view the ECB's OMT scheme as a bold measure that should lessen the likelihood of a euro breakup.

# Base Case : The Eurozone's New Recession—Confirmed

## Standard & Poor's European Economic Forecast

### --Central forecast--

	Germany	France	Italy	Spain	Netherlands	Belgium	Eurozone	U.K.	Switzerland
<b>Real GDP (% change)</b>									
2010	3.7	1.7	1.8	(0.1)	1.7	2.2	2.0	1.8	3.0
2011	3.0	1.7	0.4	0.7	1.2	2.0	1.5	0.8	2.1
2012f	0.6	0.1	(2.4)	(1.8)	(1.1)	0.0	(0.8)	(0.3)	0.8
2013(f)	1.2	0.4	(0.6)	(1.4)	(0.2)	0.5	(0.0)	1.0	1.1
2014(f)	1.7	1.3	0.9	0.7	1.4	0.9	1.2	1.6	1.3
<b>CPI inflation (%)</b>									
2010	1.2	1.7	1.6	2.0	0.9	2.3	1.6	3.3	0.6
2011	2.5	2.3	2.9	3.1	2.5	3.5	2.7	4.5	0.1
2012f	1.9	2.0	3.0	2.0	2.5	2.6	2.3	2.6	(0.5)
2013(f)	2.0	1.4	2.0	2.0	2.0	1.5	1.9	1.8	0.0
2014(f)	2.2	1.5	0.5	1.5	1.5	1.8	1.6	1.8	0.5
<b>Unemployment rate (%)</b>									
2010	7.1	9.8	8.4	20.1	4.5	8.3	10.1	7.8	4.5
2011	6.0	9.7	8.4	21.7	5.3	7.2	10.2	8.0	4.0
2012f	5.5	10.5	10.7	25.5	6.8	7.2	11.7	8.2	4.2
2013(f)	5.0	10.5	11.0	26.0	7.0	7.0	11.8	8.0	4.0
2014(f)	5.0	9.9	10.0	23.0	5.5	7.0	10.7	7.0	3.1

While the European economic outlook remains somewhat uneven across countries, in most economies it generally remains dominated by the deleveraging process occurring almost simultaneously in the public sector, the private sector, and the financial sector. Meanwhile, softness in emerging markets now appears more protracted than we initially anticipated.

Those factors lead us to forecast another year of very weak growth in 2013 in France and in the U.K., and further declines in output in Italy and Spain.

# European Corporate Defaults on the Rise

## European (EU-30) Speculative-Grade Defaults (Projections June 2013)

(% per year)	Baseline	Downside
<b>Ratings/credit estimates</b>		
Above B+	0.7	0.9
B+	2.2	2.7
B	4.5	5.9
B-	7.0	9.4
CCC / CC	23.0	28.6
<b>Default rates</b>		
Overall (%)	6.3	8.1
Number of defaults	41	53
<b>of which:</b>		
--Credit estimates (%)	7.9	10.1
--Number of defaults	32	41
--Public ratings (%)	3.6	4.7
--Number of defaults	9	12

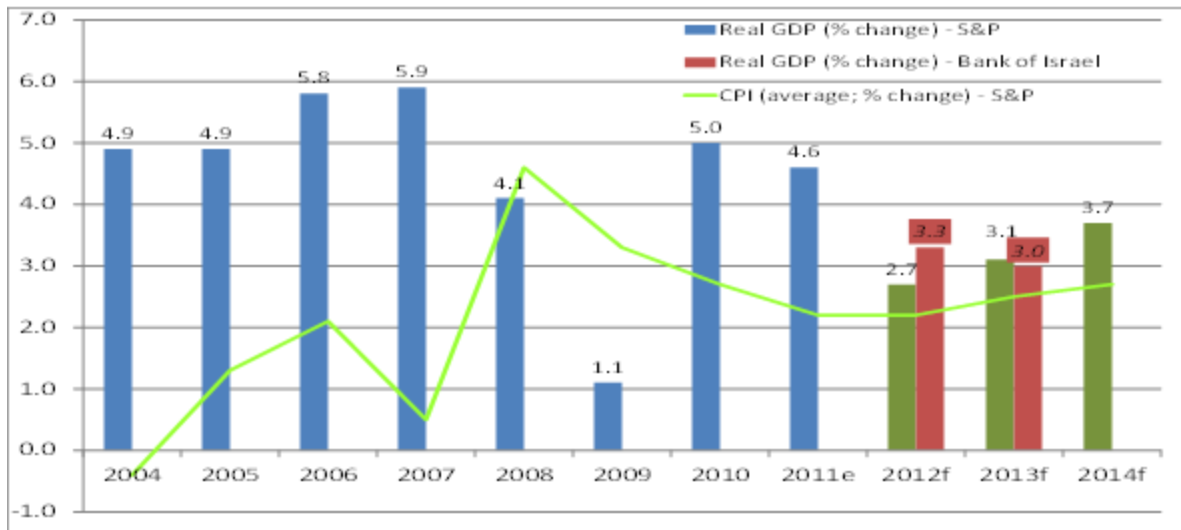
Source: Standard & Poor's.

Speculative grade default rate (LTM) could reach 6.3% by June 2013

Event risk remains significant, with a 40% chance of our downside scenario occurring, resulting in 8.1% LTM speculative grade default rate

# Israel

- The latest S&P base case forecast assumes average GDP per capita growth rate of 1.8% per year until 2015.
- As a small, open economy, Israel is highly export-dependent with exports constituting nearly 45% of GDP, with high-tech industries representing almost 50% of total industrial exports (excluding diamonds).
- Israel's strong currency and slowdowns in the U.S. and Europe have dampened export growth. Israel's continued expansion into new export markets in Asia and Eastern Europe should compensate for stagnant demand in the West.
- Israel's competitive position as a research and knowledge center continues to attract high FDI. Nevertheless, uncertainty surrounding politics and security will continue to overshadow confidence and add to downside risks



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# Default rates

## Annual Default Rates By Industry

(%)	Q2 2012*	2011	2010	2009	2008
Chemicals, Packaging and Environmental Services (50)	10.1	3.9	1.7	19.0	10.6
Consumer Products (63)	7.9	6.4	1.6	13.0	7.1
Business Equipment and Services (64)	7.8	1.7	4.5	13.3	1.4
Telecommunications (30)	6.6	3.3	8.0	11.5	3.3
Media and Entertainment (109)	5.5	6.4	6.7	14.3	4.5
Oil and Gas, Exploration and Production (21)	4.8	0.0	4.5	0.0	0.0
Capital Goods (43)	4.7	7.0	3.8	10.0	1.7
Retail/Restaurants (69)	4.4	7.0	2.6	22.7	5.1
Homebuilders/Real Estate (50)	4.0	3.9	0.0	22.6	11.3
High Technology (25)	4.0	0.0	9.5	22.2	5.0
Healthcare (60)	3.3	3.3	3.2	3.3	3.2
Automotive (38)	2.6	4.9	2.5	23.7	9.5
Transportation (40)	2.5	7.4	4.8	7.5	4.9

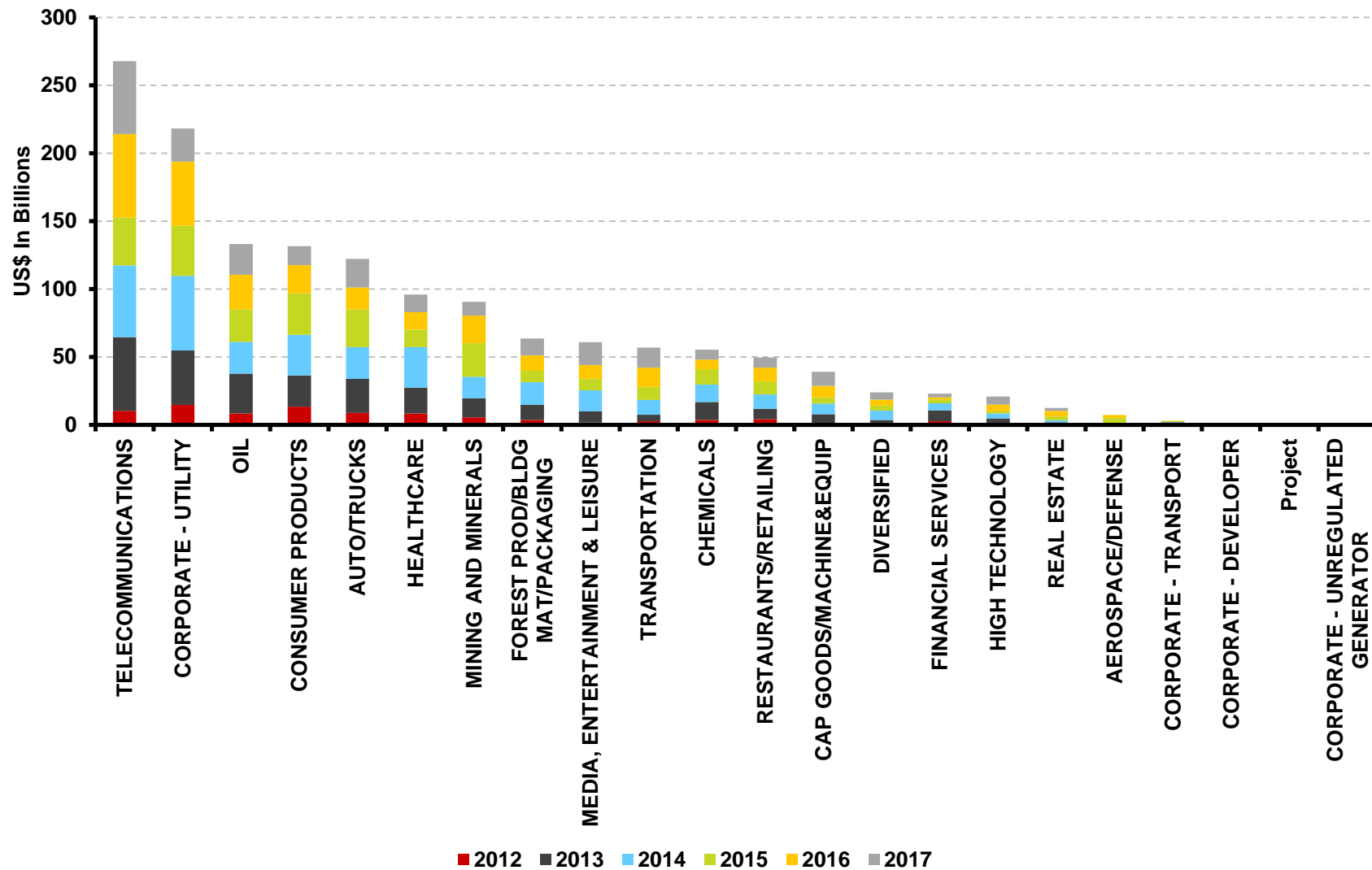
\*Trailing 12-month default rate to June 30, 2012. Source: Standard & Poor's.

Average	5.3	4.6	4.5	13.6	5.2
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Telecoms not far from the average. Generally late-cyclical.

But Europe's largest default so far this year was a telecom company (Eircom, €4.4 billion, Feb 2012)

# Industry Specific Maturities– Europe (\$ amount)



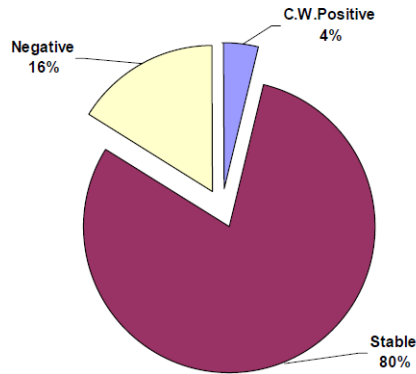
Standard & Poor's Rated Debt (Bonds & Loans)

July 1st, 2012

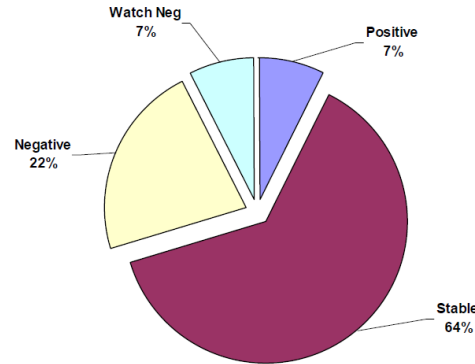
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# EMEA Telecom, Cable & Satellite: Outlook & CreditWatch Distribution

Dec. 31, 2011



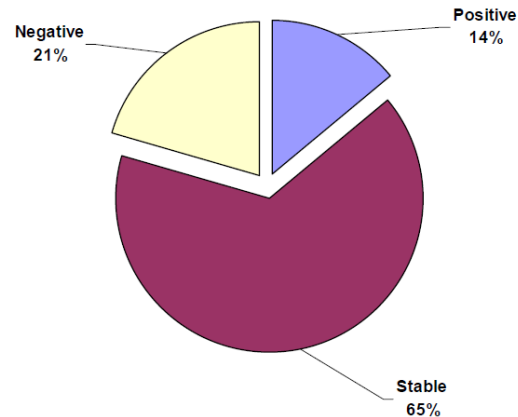
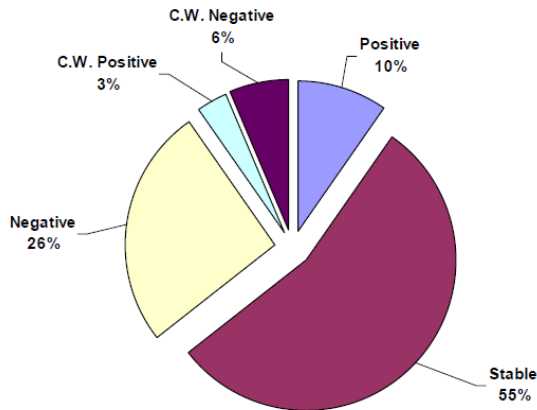
Sept 25, 2012



Investment Grade

Over the past few quarters we have had negative « bias » at least as high for investment grade as for speculative grade ratings.

EMEA IG Corporates have c. 80% stable outlooks on average. Main reasons are GIPS issuers and generally high exposure to depressed domestic consumer demand, and late adjustments of shareholder policies.



Speculative Grade

The relatively high proportion of Positive outlooks for Speculative grade issuers primarily reflects positive operating trends for cable issuers.

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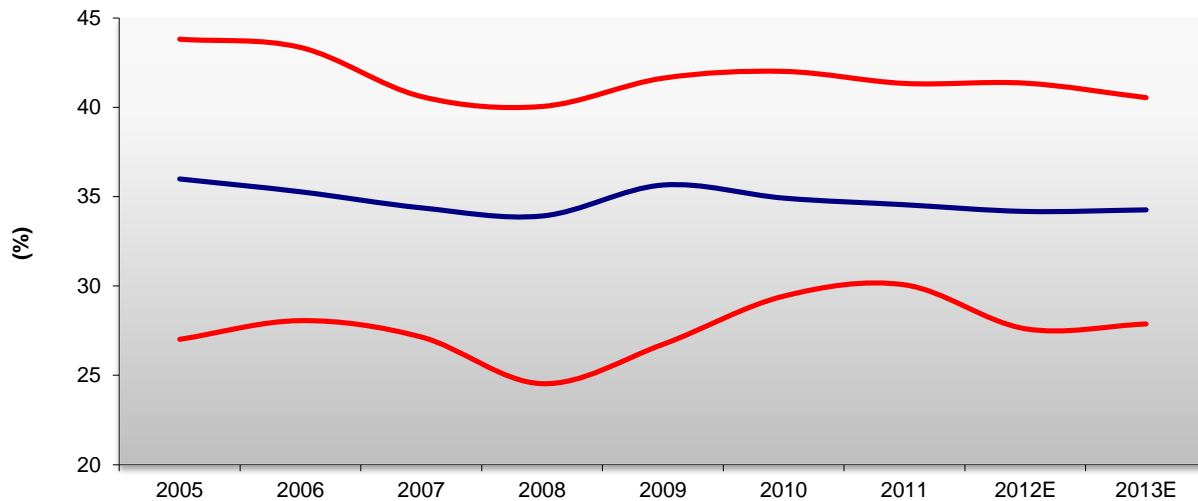
# European Telecom Sector Trends

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# The Largest Telcos Face Continued Margin Compression

**Top 15 EBITDA margins (adj.)**  
- Low / High  
- Average (unweighted)



Previously lower-margin players (Telia, Telenor, BT) on improving trajectory, while pressure builds for most others. In-market M&A remains elusive. Handset subsidies to continue hitting postpaid margins. Accounting treatments may shift opex to capex.

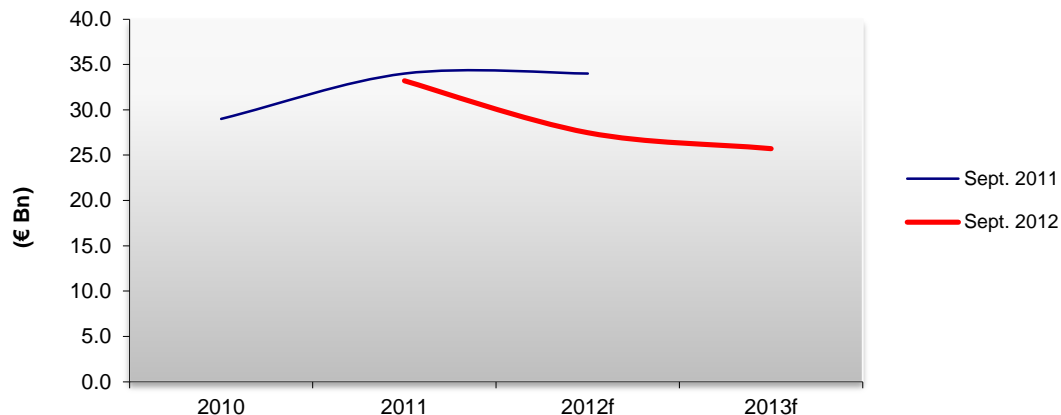
# Top Telcos Have Been Particularly Hit

Corporate Credit Ratings On The Top 15 Rated European Telecom Companies				
Company	Unchanged*	Downgrade*	Adverse Outlook revision or Creditwatch placement, without a rating downgrade*	Positive outlook revision*
Belgacom S.A.		A/Stable/A-2		
BT Group PLC	BBB/Stable/A-2			
Deutsche Telekom AG			BBB+/Stable/A-2	
France Telecom S.A.			A-/Negative/A-2	
Koninklijke KPN N.V.		BBB/Stable		
Portugal Telecom SGPS S.A.		BB+/Negative		
Swisscom AG	A/Stable/--			
TDC A/S				BBB/Positive/A-2
Telecom Italia SpA			BBB/Negative/A-2	
Telefonica S.A.		BBB/Negative/A-2		
Telekom Austria AG	BBB/Stable/A-2			
Telenor ASA	A-/Stable/A-2			
TeliaSonera AB	A-/Stable/A-2			
Vivendi S.A.			BBB/WatchNeg/A-2	
Vodafone Group PLC	A-/Stable/A-2			
Count	10	4	4	1

\* Between Sept 26, 2011 and Oct. 16, 2012

# Shareholder Policy Revisions Are Helping Offset Operating Pressures

**Top 15 Dividends  
Standard & Poor's forecasts**

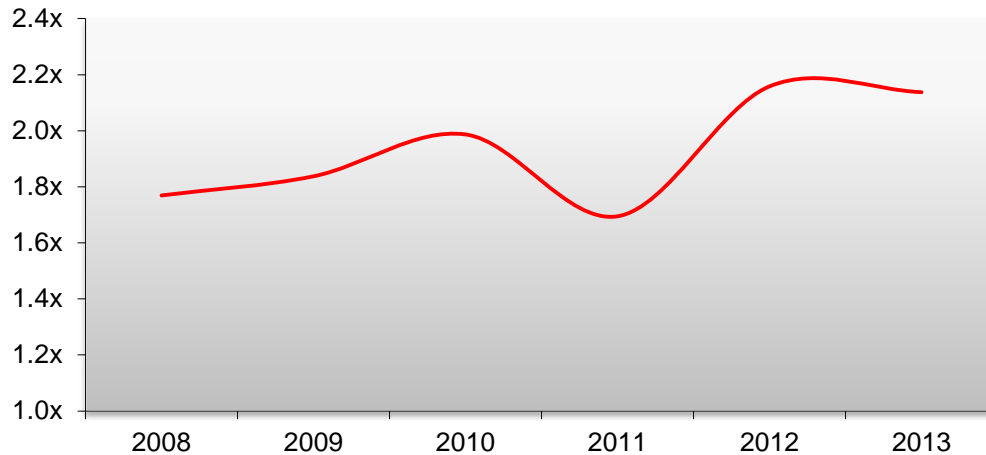


Cuts are even more steep if one considers that some one-time dividends (Vodafone-VZW) were not included last year

	Date	Change
France Telecom	Jun-12	2012 DPS reduced to 1.21-1.35 from 1.40. In December 2011 FT also announced that disposal proceeds would not be returned to shareholders, contrary to previous expectations
KPN	Jul-12	DPS of 35c for 2012, down from a previously expected 90c. Savings of €0.8bn
Portugal Telecom	Jun-12	DPS of 32.5c for 2012-2014, down from 65c for 2011
Telecom Italia	Feb-12	€0.9bn in cash for 2012, down from €1.2bn (with yearly growth guidance of 15%) in 2011
Telefonica	Jul-12	Suspension of dividend for Nov 2012 and May 2013. Saving €6.8 billion. This followed a scrip dividend announcement in June 2012.
Telekom Austria	December 2011/Sept 2012	DPS floor halved to 0.38 per share, for 2011 and 2012; DPS cut to 0.05ct per share for 2012 and 2013 in Sep. 2012
Vivendi	Mar-12	DPS cut to €1.0 for 2011 plus one share for each 30 owned, down from €1.4 for 2012
<b>DPS--Dividend per share</b>		

# But Not Quite Enough, Especially Given Investment Requirements

**Top 15 Capital expenditures / dividends  
Standard & Poor's forecasts**

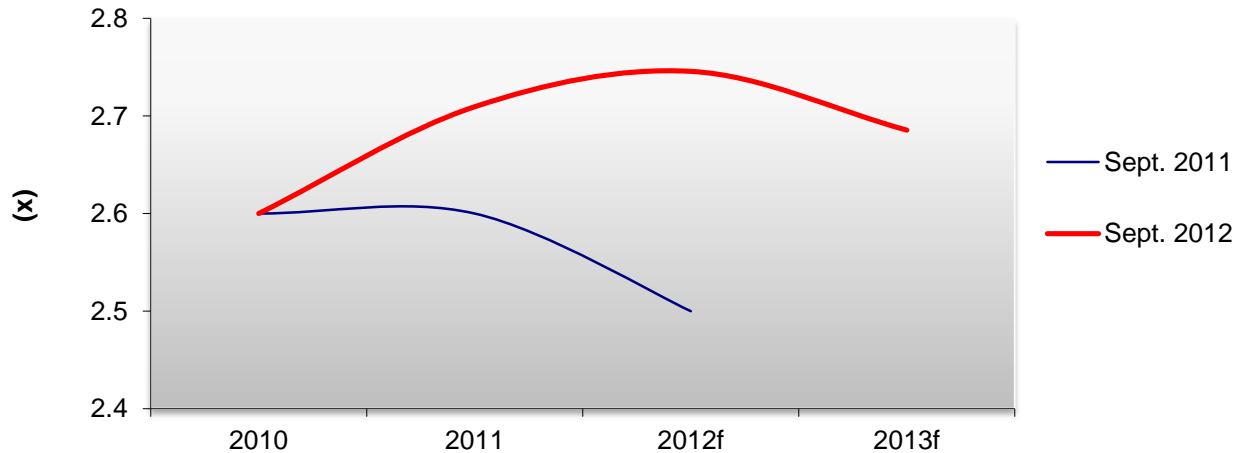


4G spectrum purchases and mobile and fixed broadband rollouts force carriers to continue investing.

The industry goes « back to basics » ie technology investments with encouraging experiences of differentiation thorough network quality (PT, Swisscom).

# Headroom For Further Earnings Pressures Or M&A Is Very Small

Top 15 Debt / EBITDA, weighted average  
Standard & Poor's forecasts, adjusted



Headroom for further dividend cuts is declining

Some of the largest debt borrowers have limited deleveraging capacity (TEF, TI, KPN) or willingness (FT, DT, VOD)

# Conclusions

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## Negative credit trends:

- The economic outlook continues to deteriorate, forcing telecom companies to accelerate cost cuts, while consolidation remains elusive
- Issuers with earnings pressure and large debt maturities have struggled to maintain ratings, especially those based in GIPS (eg Telefonica) although recent market improvements have re-opened refinancing windows. But maturities remain very large, discretionary cash flows insufficient and competition for capital in the BBB band is fierce.
- The high yield market shows appetite for even aggressive deals, which could put renewed pressure on credit quality

## Positive credit trends:

- Issuers with favorable earning trends (especially in the cable segment) and proactive refinancing enjoy favorable rating trends and debt market access (eg Liberty Global, Virgin Media) even in GIPS markets (eg ONO)
- The silver lining of the current cloudy economic prospects may be that some issuers focus less on immediate cash generation and shareholder returns, and more on long-term competitive strength through network investment.

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# Israeli Telecom Sector

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# Business Risk – Israeli Telecoms

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- **Increasing regulatory involvement has led to increased competition and greater commoditization of services. Regulator in our view will likely focus more on the television sector next year.**
- **Increased competition with multiple new entrants**
  - greater commoditization of services
  - change in branding as companies try to re-invent brand value
  - increased look at package deals (triple and quadruple play).
- **Fast response by incumbents (market share still strong)**
  - competitive pricing to maintain market share
  - less subsidies for handset sales
  - lower distributions (for now)



# Key points Israeli Telecoms vs. European Telecoms

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- **Similar regulatory and competitive dynamics.**
  - Brutal repricing in Israel akin to Spain / France / Italy potentially
- **EBITDA margins potentially trending below**
  - UK example suggests large, data-intensive 4-player markets can have lower margins still.
- **FFO/Debt metrics generally lower**
- **Greater leverage (Debt/EBITDA)**
- **Lower capitalization (less equity)**
- **Indebted shareholders are an additional risk for Israeli telcos**

# Israeli Telecoms Market – Where To From Here?

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- **Competition likely to continue for the short term at least though new entrant's prices may go up and allow incumbents to raise prices as well.**
- **Less handset sales likely to lower revenue but stabilize working capital.**
- **Triple and quadruple play packages may affect overall market share. If Bezeq gets into the game this could allow it to maintain and increase market share and improve performance.**
- **Minimum possible capital expenditure. Will focus on maintaining network and competitive position and for mobile operators investment in television packages. 4G auction may change everything.**
- **Shareholder distribution a big question. Currently companies have been trying to strengthen cash position but how long will shareholders let them.**

# Rating Outlook For Israeli Credits

	National Scale Rating	Outlook / CreditWatch Statement (date)
Partner	ilAA-/CW Neg	<p>אנו מצפים לפתור את ה-CreditWatch תוך 90 יום מ-10 בספטמבר, 2012. בכוונתנו להיפגש עם החברה ולאמוד את חשיפתה למצב סקיילקס לרבות ביחס לחלוקת דיבידנדים, את תכניתיה לניהול נזילותה ואת השפעת התגברות התחרות על תוצאותיה העתידיות.</p> <p>להערכתנו, במידה והחברה לא תציג מתווה ברור לשיפור הנזילות לרמה "מספקת", כהגדרתנו, במקביל להתמודדות עם האתגרים התחרותיים תתכן ירידה מרובת נוטצ'ים בדירוג החברה. אנו עשויים לאשרר את הדירוג הנוכחי אם נשתכנע כי חשיפת החברה למצבה של סקיילקס הנה מגודרת ולא צפויה להשפיע לשלילה באופן מהותי, לדעתנו, על מצב החברה, ועם הצגת מתווה ברור כאמור, יחד עם אינדיקציה ברורה לגבי יכולת שימור מעמדה העסקי של החברה ושימור היחסים הפיננסיים ברמה התואמת את הדירוג, לדעתנו.</p>
Bezeq	ilAA+/Negative	<p>תחזית הדירוג השלילית משקפת את הערכתנו שפרופיל הסיכון הפיננסי של בזק צפוי להיות גבולי עבור דירוג 'ilAA+', עקב צפייתנו לביצועים תפעוליים חלשים יותר בשנת 2012, הנובעים בעיקר מהפעילות הסלולרית וכן מהעלייה בחוב כתוצאה מתזרים מזומנים פנוי שלילי צפוי בגובה של כחצי מיליארד ₪ ב-2012.</p> <p>אנו עשויים להוריד את הדירוג אם יחס החוב המתואם ל-EBITDA יתקרב לרמה של 2.5x, המשקף יחס של מעט מעל ל-3.0x לאחר הכללת 100% מחוב הבעלים, ללא תוואי ברור להורדת המינוף. כמו כן, אנו עלולים להוריד את הדירוג במידה ולא יחול שיפור משמעותי בתזרים המזומנים הפנוי ולא תבוצע מדיניות ברורה להקטנת הגירעון וחזרה לתזרים מזומנים פנוי חיובי בטווח הבינוני.</p> <p>עם זאת, אנו עשויים לשנות את תחזית הדירוג ליציבה אם הביצועים התפעוליים של בזק יישארו יציבים ויחול שיפור בתזרים המזומנים הפנוי. כמו כן, מדיניות פיננסית שמרנית, הכוללת קיצוץ בסכום הדיבידנדים המחולק, תתמוך אף היא ביציבות הדירוג. יתר על כן, אנו צופים שינויים רגולטורים בענף הטלפון הקווי, אשר עשויים להיות בעלי השפעה חיובית על הרווחיות ועל השמירה על מעמדה המוביל של בזק. יישום ההוראות הרגולטוריות ובמיוחד הסרת ההפרדה המבנית בין בזק לבין החברות הבנות שלה, בכפוף להשלכות שלו על הביצועים התפעוליים, עשוי לתרום לתחזית הדירוג.</p>
Pelephone	ilAA+/Negative	
Cellcom	ilAA-/Negative	<p>תחזית הדירוג השלילית משקפת את האפשרות להורדת הדירוג ל-'ilA+' במהלך 12-18 החודשים הקרובים כתוצאה מירידה בהערכת הסיכון העסקי והמשך העלייה במינוף.</p> <p>הדירוג עשוי לרדת במידה והערכתנו אודות הסיכון העסקי של סלקום תרד כתוצאה מפגיעה במעמדה התחרותי של סלקום בעקבות התגברות התחרות, לדוגמה בשל ירידה בנתח השוק שלה אל מתחת ל-30% וירידה בשיעור הרווחיות לאזור ה-25%. הורדת הדירוג אפשרית גם אם יחס החוב ל-EBITDA המתואם יגיע לכ-3.5x ללא התאמה במדיניות הפיננסית של החברה על מנת להקטין את היקפי החוב.</p> <p>אנו רואים ביחס חוב ל-EBITDA מתואמים סביב 3.0x, ורווחיות של כ-30% כהולמים את הדירוג הנוכחי וזאת במידה והנ"ל מלווים בצמצום בחלוקת הדיבידנדים ושמירה על מדיניות ניהול נזילות פרואקטיבית. במידה וזה אכן יהיה המצב ייתכן כי הדירוג יתייצב.</p>
Scailex	ilCC/Negative	<p>תחזית הדירוג השלילית משקפת את הערכתנו כי מצב נזילות החברה נשאר תנודתי עד כדי שהחברה לא תעמוד בהתחייבויותיה בטווח הנראה לעין. ייתכן כי הדירוג ירד ל-'SD' או ל-'D' אם החברה לא תעמוד בתשלום תקופתי כלשהו או תישם עיסקה אשר תיחשב, לשיטתנו, כ-"distressed exchange offer".</p>

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