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Research Update:

Cyfrowy Polsat 'BB' Rating Affirmed On Imminent Acquisition Of Metelem; Proposed Debt Rated 'BB'; Outlook Stable

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Table Of Contents

Overview

Rating Action

Rationale

Outlook

Ratings Score Snapshot

Recovery Analysis

Related Criteria And Research

Ratings List

Research Update:

Cyfrowy Polsat 'BB' Rating Affirmed On Imminent Acquisition Of Metelem; Proposed Debt Rated 'BB'; Outlook Stable

Overview

- Most of the conditions for the acquisition of Poland-based wireless telecommunications company Metelem Holding Company Ltd. (Metelem) by Polish media group Cyfrowy Polsat S.A. have been met, and we anticipate that the acquisition will close soon.
- The acquisition materially increases Cyfrowy Polsat's diversity and scale. We are therefore revising our assessment of Cyfrowy Polsat's business risk profile upward to "satisfactory" from "fair."
- At the same time, we are revising our assessment of Cyfrowy Polsat's financial risk profile downward to "significant" from "intermediate" because we anticipate that higher leverage at Metelem will weaken Cyfrowy Polsat's financial metrics.
- We are affirming our 'BB' long-term corporate credit rating on Cyfrowy Polsat, and assigning our 'BB' issue rating to Cyfrowy Polsat's proposed Polish zloty (PLN) 2.5 billion term loan and proposed PLN500 million senior secured revolving credit facility.
- The stable outlook reflects our view that Cyfrowy Polsat will successfully integrate Metelem and gradually improve its credit metrics.

Rating Action

On April 30, 2014, Standard & Poor's Ratings Services affirmed its 'BB' long-term corporate credit rating on Polish media group Cyfrowy Polsat S.A. The outlook is stable.

At the same time, we assigned our 'BB' issue rating to Cyfrowy Polsat's proposed Polish zloty (PLN) 2.5 billion term loan and proposed PLN500 million senior secured revolving credit facility (RCF).

Rationale

The affirmation follows the meaningful progress that Cyfrowy Polsat has made toward the completion of its acquisition of Poland-based wireless telecommunications company Metelem Holding Company Ltd. (Metelem). We understand that all main conditions for the acquisition--in particular, the refinancing of Cyfrowy Polsat's existing debt--have been met, and we therefore anticipate that the acquisition will close in the short term.

In our view, the acquisition materially increases Cyfrowy Polsat's diversity and scale by combining Poland's largest direct-to-home pay-TV and mobile telecoms operators. We are therefore revising our assessment of Cyfrowy Polsat's business risk profile upward to "satisfactory" from "fair." Post the acquisition, we forecast that Cyfrowy Polsat will report revenues of close to PLN10.0 billion and Standard & Poor's-adjusted EBITDA of about PLN4.2 billion, of which roughly two-thirds will come from Metelem's mobile operations marketed under the Polkomtel brand.

Although the acquisition is an all-share deal, we anticipate that higher leverage at Metelem will weaken Cyfrowy Polsat's financial metrics. Under our base case, we forecast an adjusted debt-to-EBITDA ratio pro forma the acquisition of about 3.4x in 2014, and adjusted free operating cash flow (FOCF) to debt of about 10%, which is commensurate with the lower end of our "significant" financial risk profile category. We are therefore revising our assessment of Cyfrowy Polsat's the financial risk profile downward to "significant" from "intermediate."

Cyfrowy Polsat plans to issue a PLN2.5 billion term loan and PLN500 million senior secured RCF, as well as use existing funds, to refinance existing debt and the payment-in-kind notes at Metelem. While the amortizing nature of the proposed term loan will reduce Cyfrowy Polsat's leverage, we see a risk that higher integration costs than we anticipate may delay improvement in the group's ratios. In addition, we view the distribution restrictions in the Polkomtel's debt documentation as negative, as we anticipate that they will prohibit Cyfrowy Polsat from accessing Polkomtel's cash flows at least until 2016. As a result, we currently apply a one-notch downward adjustment to Cyfrowy Polsat's anchor of 'bb+' to account for our comparable rating analysis, whereby we review an issuer's credit characteristics in aggregate.

Our base-case scenario for Cyfrowy Polsat assumes:

- GDP growth in Poland of 2% in 2014;
- About PLN3 billion revenues from Cyfrowy Polsat's retail and TV broadcasting segments.
- A revenue decline of 2%-4% for Polkomtel in 2014 and about 1% revenue growth in 2015.
- Cost synergies increasing Cyfrowy Polsat's adjusted EBITDA margin by 100 basis points to about 43% in 2014 and 44% in 2015.

Based on these assumptions, we arrive at the following credit measures:

- Adjusted FOCF to debt of about 10% in 2014, down from about 27% in 2013, and improving to 14%-15% in 2015.
- An adjusted debt-to-EBITDA ratio of about 3.4x in 2014, up from about 1.6x in 2013, and improving to 2.9x in 2015.

Liquidity

We view Cyfrowy Polsat's liquidity as "adequate" under our criteria, and we calculate that liquidity sources should exceed liquidity needs by more than 1.2x over the next 12 months. As Polkomtel's cash flows are effectively ring-fenced until its debt has been refinanced, we analyze Cyfrowy Polsat's

liquidity excluding Polkomtel's sources or uses.

We calculate Cyfrowy Polsat's main sources of liquidity over the next 12 months as:

- Cash and cash equivalents of about PLN0.6 billion (assuming the repayment of Metelem's debt);
- An RCF of PLN500 million maturing in 2019; and
- Unadjusted funds from operations (FFO) of about PLN700 million.

Over the same period, we calculate the following uses of liquidity:

- Our estimation of working capital outflows of about PLN50 million;
- Our estimation of capital expenditures of about PLN250 million, including investments in set top boxes.
- Loan amortization payments of PLN170 million; and
- PLN100 million of dividends.

Furthermore, we believe that headroom under Cyfrowy Polsat's senior secured loan's financial covenants will remain adequate over the medium term, even if EBITDA were to decline by 15%. We anticipate significant headroom (more than 30%) under new covenants over the next two years.

Outlook

The stable outlook reflects our view that Cyfrowy Polsat will successfully integrate Metelem, thereby improving its credit metrics over the next 12 months to a level comfortably in line with a "significant" financial risk profile. The outlook also reflects our view that Cyfrowy Polsat will not have access to Polkomtel's cash flows until Polkomtel's debt has been refinanced or Polkomtel deleverages meaningfully, neither of which we anticipate over the next 12 months.

Upside scenario

We could raise the rating if Cyfrowy Polsat achieves adjusted debt to EBITDA of less than 3x and adjusted FOCF to debt of at least 15%, both on a sustainable basis. If the refinancing of Polkomtel's debt results in full access to Polkomtel's cash flows, it could also lead to an upgrade.

Downside scenario

We see limited risk of a downgrade as we anticipate that Cyfrowy Polsat will start to deleverage over the short term through a combination of debt reduction and transaction synergies. We could, however, lower the rating if difficulties in integrating Polkomtel or weaker operating performance than we expect reversed Cyfrowy Polsat's deleveraging such that adjusted FOCF to debt dropped below 10% on a sustainable basis, or adjusted debt to EBITDA increased to more than 4x.

Ratings Score Snapshot

Corporate Credit Rating: BB/Stable/--

Business risk: Satisfactory

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

Financial risk: Significant

- Cash flow/Leverage: Significant

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: Satisfactory (No impact)
- Comparative rating analysis: Negative (-1 notch)

Recovery Analysis

The issue rating on the proposed PLN2.5 billion senior secured term loan and the PLN500 million proposed senior secured RCF, both ranking pari passu and with a five-year term, is 'BB', the same level as the corporate credit rating on Cyfrowy Polsat. We consider the term loan to be well secured because it benefits from first-ranking registered pledges over present and future assets of Cyfrowy Polsat; pledges over shares in Metelem; first-ranking mortgage over real estates, bank accounts, and receivables; as well as guarantees from Cyfrowy Polsat and its subsidiaries.

In a default scenario, the proposed term loan and RCF would be structurally subordinated to Polkomtel's debt. However, in our view, such subordination is mitigated by the existence of significant operating assets at Cyfrowy Polsat, with the loan having security over those assets. In addition, there is no cross-default mechanism between Cyfrowy Polsat and Metelem. As a result, we do not notch the issue rating on the loans downward for structural subordination.

Related Criteria And Research

Related criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013

- Corporate Methodology, Nov. 19, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

Ratings List

Ratings Affirmed

Cyfrowy Polsat S.A. Corporate Credit Rating	BB/Stable/--
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Cyfrowy Polsat Finance AB Senior Secured*	BB
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New Rating

Cyfrowy Polsat S.A. Senior Secured	BB
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*Guaranteed by Cyfrowy Polsat S.A.

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