PLDT Inc.

Fitch Revises PLDT's LC IDR Outlook to Stable; Affirms IDRs

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Fitch Ratings-Singapore-30 August 2017: Fitch Ratings has revised the Outlook on PLDT Inc.'s Long-Term Local-Currency Issuer Default Rating (LC IDR) to Stable from Negative. The LC IDR has been affirmed at 'BBB+'. The agency has simultaneously affirmed the Philippine telco's Long-Term Foreign-Currency IDR (FC IDR) at 'BBB', and its National Long-Term Rating at 'AAA(phl)'. The Outlook on the FC IDR and National Long-Term Rating is Stable.

The Outlook revision reflects Fitch's expectations that PLDT can maintain FFO adjusted net leverage at under or around 2.5x (2016: 2.6x), above which Fitch would consider negative rating action. PLDT has been divesting non-core assets in its commitment towards deleveraging. The rating action also incorporates Fitch's expectation of a gradual recovery in EBITDA, reflecting the company's strategic focus on profitable growth and expanding fixed-line revenue. However, rating headroom for the LC IDR remains limited.

The FC IDR has been affirmed at 'BBB' and remains capped at the Philippines' Country Ceiling of 'BBB', reflecting the additional risks associated with transfer and convertibility of foreign-currency in the country.

KEY RATING DRIVERS

Non-Core Asset Sale: PLDT sold its remaining 25% stake in Beacon Electric Asset Holding in June 2017 for PHP21.8 billion, of which it had received PHP12 billion to date. The remaining proceeds will be paid over annual instalments from June 2018 to June 2021, along with another PHP9.2 billion from an earlier sale of Beacon shares in May 2016.

PLDT is also in the process of selling its 18.3% economic interest in business outsourcing company, SPi Global, which we have not factored into our projections. The USD330 million deal, which includes private equity firm CVC Capital Partners' majority stake in SPi, is pending completion subject to closing conditions. The amount of the cash distribution to PLDT is not yet determined, though we anticipate

deleveraging impact to be small, at less than 0.1x.

Return to Profitable Growth: PLDT's strategy change to focus more on profitability rather than market share should stabilise price competition and ease EBITDA margin pressure. Fitch anticipates progressive EBITDA improvements in the medium term. PLDT is targeting PHP70 billion in EBITDA this year (2016: PHP61 billion) through cost management and handset subsidy cuts. It also expects continued double-digit growth in home and enterprise revenue to drive EBITDA, although this is likely to be offset by falls in SMS, international and mobile voice revenue. Fixed-line accounted for 45% of PLDT's EBITDA in 1H17, while the remaining 55% was from the wireless segment.

High Capex: The aggressive rollout of the long-term evolution (LTE) network and fibre expansion to drive PLDT's digital pivot strategy is likely to maintain capex/revenue ratio at 25%-27% in 2017-2018 (2016: 26%). PLDT revised down 2017 capex guidance by PHP6 billion to PHP38 billion, anticipating a delay in network completion to early 2018. However, we expect annual capex to stay elevated at around PHP46 billion for the next two years. PLDT has a three-year plan to accelerate LTE expansion to cover 95% of the country's cities and municipalities by 2018. It aims to expand its fibre reach to cover 4 million homes by end-2017 and 6 million by 2020 (end-June 2017: 3 million).

Leading Market Position: PLDT's ratings reflect its leading position in the Philippines, with 70% subscriber market share in fixed-line and 48% revenue market share in mobile. PLDT competes against the second-largest telecom operator, Globe Telecom, Inc. (BBB-/Stable), and benefits from its fully integrated fixed and mobile services, which enable convergence. In addition, the joint acquisition of San Miguel Corporation's telecom assets by PLDT and Globe should remove the threat of new competition in the medium term.

DERIVATION SUMMARY

PLDT's credit profile reflects its strong position in both fixed and wireless markets in the Philippines, strengthening its status as an integrated telecom operator. The company's diversified operations and wide operating margins compare favourably against similarly leveraged fixed-line peer, Telekom Malaysia Berhad (TM, A-/Stable, standalone profile: BBB+). TM benefits from benign competition in its near monopolistic fixed-broadband market, but its broadband EBITDA margins of around 30% are likely to narrow further due to cost pressure from its new mobile business and the risk of broadband tariff cuts.

PLDT's strong domestic profile and EBITDA margins are also comparable with Thailand's largest mobile operator, Advanced Info Service Public Company Limited (AIS, BBB+/Stable). However, AIS's conservative balance sheet offsets the competitive industry structure and its lack of product diversification. PLDT is rated higher than domestic peer, Globe, due to the latter's higher net leverage of 3.0x, smaller scale and lower low-single-digit pre-dividend FCF margin. No parent/subsidiary or operating environment aspects impacts the rating. The FC IDR and senior unsecured ratings are capped by the Philippines' Country Ceiling.

KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:
- Group revenue to remain stagnant in 2017, as the expanding home broadband and enterprise segments offset sluggish performance in wireless operations, primarily consisting of legacy voice and SMS services. We expect group revenue to increase by low single-digit percentages in 2018-2019
- Operating EBITDA margin of around 41% in 2017-2019, supported by lower handset subsidies and stable competition
- Capex/revenue ratio of 26%-27% in 2017-2019
- Payment of PHP6.6 billion in May 2017 relating the last instalment for PLDT's equity interest in San Miguel Corporation's telecom businesses
- Staggered proceeds in 2017-2020 from the PHP21.8 billion divestment of Beacon in June 2017 and PHP9.2 billion remaining proceeds from an earlier sale of its equity interest in May 2016
- PHP4.2 billion perpetual notes treated as debt.

RATING SENSITIVITIES

Developments that May, Individually or Collectively, Lead to Positive Rating Action
Fitch does not envisage any upgrade to PLDT's Long-Term Local-Currency Issuer Default Rating (IDR) given the company's business profile and investment needs. However, PLDT's Long-Term Foreign-Currency IDR could be upgraded if there is positive rating action on the Philippines' Country Ceiling.

Developments that May, Individually or Collectively, Lead to Negative Rating Action
- PLDT's Local-Currency IDR could be lowered if FFO adjusted net leverage rises above 2.5x for a

sustained period.
- Negative rating action on the Philippines' Country Ceiling will result in corresponding action on PLDT's Foreign-Currency IDR.

LIQUIDITY

Strong Liquidity: PLDT's unrestricted cash balance of PHP34 billion as at end-June 2017 was sufficient to fully cover its short-term maturities of PHP15 billion. The company's liquidity is also supported by strong access to capital markets and banks, while the pending divestment of its 18.3% economic interest in SPi should provide added financial flexibility. PLDT's total on-balance sheet debt of PHP175 billion as of end-June 2017 (end-June 2016: PHP129 billion) is well spread out, with 76% of debt due after 2019.

Approximately 23% of debt was US dollar-denominated, following the refinancing of its 8.35% USD228 million bonds in March 2017 with the Philippine peso. The unhedged portion of its US dollar-denominated debt net of its dollar cash balance was 9%. Dollar-linked revenue - consisting of international long-distance, international leased lines and mobile virtual operator businesses - provide a natural hedge, at 17% of PLDT's consolidated service revenue (1H16: 16%).

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Summary of Financial Statement Adjustments - Fitch has treated the PHP5.3 billion perpetual notes issued by PLDT's wholly owned subsidiary, Smart Communications, in March and July 2017 as debt. PLDT's financial reporting treats the perpetual notes as equity.

Note to editors: Fitch's National ratings provide a relative measure of creditworthiness for rated entities in countries with relatively low international sovereign ratings and where there is demand for such ratings. The best risk within a country is rated 'AAA' and other credits are rated only relative to this risk. National ratings are designed for use mainly by local investors in local markets and are signified by the addition of an identifier for the country concerned, such as 'AAA(phl)' for National ratings in the Philippines. Specific letter grades are not therefore internationally comparable.

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Additional information is available on www.fitchratings.com

The following issuer(s) did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure: PLDT Inc.

Applicable Criteria

Corporate Rating Criteria (pub. 07 Aug 2017)

National Scale Ratings Criteria (pub. 07 Mar 2017)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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