

ISSUER COMMENT

1 September 2020

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RATINGS

Telecom Italia S.p.A.

Outlook	Negative
Corporate Family Rating	Ba1
Sr Unsec Bank Credit Facility -Dom Crr	Ba1/LGD4
Senior Unsecured	Ba1/LGD4

Telecom Italia Finance, S.A.

Outlook	Negative
Bkd Senior Unsecured - Dom Curr	Ba1/LGD4

Telecom Italia Capital, S.A.

Outlook	Negative
Bkd Senior Unsecured	Ba1/LGD4

Olivetti Finance NV

Outlook	Negative
Bkd Senior Unsecured - Dom Curr	Ba1/LGD4

Source: Moody's Investors Service

Analyst Contacts

Carlos Winzer +34.91.768.8238
 Senior Vice President
 carlos.winzer@moody's.com

Pilar Anduiza +34.91.768.8220
 Associate Analyst
 pilar.anduiza@moody's.com

Ivan Palacios +34.91.768.8229
 Associate Managing Director
 ivan.palacios@moody's.com

Telecom Italia S.p.A.

Creation of FiberCop and its potential merger with Enel's Open Fiber has both positive and negative implications for TI

On August 31, 2020, Telecom Italia (TI, Ba1 negative) announced an agreement with KKR and Fastweb, owned by [Swisscom AG](#) (A2 stable) for the creation of FiberCop, the new entity that will further develop fiber-to-the-home (FTTH) in Italy. This will include TI's last mile network, i.e. the section of the network from the cabinet to customers' premises. TI will retain 58% of FiberCop and receive €1.8 billion in cash from KKR in exchange for a 37.5% stake in FiberCop, with Fastweb keeping a 4.5% stake. Closing of the FiberCop transaction is expected by Q1 2021, once regulatory approvals are obtained.

In addition, TI has signed a letter of intent with government-owned entity [Cassa di Risparmio di Roma e Prestiti S.p.A.](#) (CDP Baa3 stable), to negotiate the potential merger of FiberCop with [Enel S.p.A.](#)'s (Enel, Baa2 Positive) OpenFiber, with the objective of establishing a single nationwide fiber network company (AccessCo). The full due diligence, including the valuation of TI's and Open Fiber's existing telecom infrastructure assets could be completed by the end of 2020, and an agreement could be reached by Q1 2021. An agreement on asset valuations may be challenging, but importantly, the principles and methodology to determine the merger conditions have been agreed for the values of both FiberCop as well as for Open Fiber. More important, the final valuations will be defined by third party valuers appointed by the companies, which reduces the risk of not agreeing on merger terms, particularly after the Government, ENEL's main shareholder, has endorsed the letter of intent with CDP for the creation of a nationwide single network.

We see these two announcements as a first step in the road map towards the broader objective of merging FiberCop with Enel's Open Fiber in order to create a nationwide single fiber infrastructure company (AccessCo) controlled by TI. The creation of this entity could alleviate competitive pressures in the wholesale business, a positive for TI. Also, the fiber network will be developed on the basis of a co-investment model open to all other operators, in accordance with the provisions of the European Electronic Communications Code.

We also see as a positive the fact that TI will be the exclusive supplier for the construction and maintenance of the networks and will provide additional services to FiberCop, which will enhance TI's revenues.

Although these announcements have further potential positive implications, because they align the government's telecom infrastructure policies with TI's need to enhance its network within its currently constrained financial flexibility, there are also negative implications, which may more than offset these positives.

On the negative side, we note that these deals will increase the analytical complexity of the group. Although TI will control and fully consolidate FiberCop and eventually the possible combination of FiberCop and Open Fiber (AccessCo), TI will not own 100% of either of these two new entities.

Secondly, TI is diluting its ownership in a strategic asset, reducing its influence over strategic and operational decisions affecting the network. By diluting its ownership in this strategic asset, this may weaken its cash flow generation after 2025. TI indicated that FiberCop will have an EBITDA of €900 million and EBITDA-Capex will be positive only in 2025. The shareholder agreements with third party minorities may imply dividend payments which would dilute TI's cash flow generation. However, no dividend payment is envisaged from FiberCo through 2022.

Finally, it is unclear at this point how much debt will be sitting on the newly created entities and, despite the initial intercompany loan, the possible presence of third party debt at the operating company level will increase the risk of structural subordination.

We will continue monitoring developments on these new plans and comment on the credit implications as they become more visible.

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