Distressed Credit Research: **Altice France**
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Content: **Debt buybacks, XpFibre and near-term cash flows in focus**

This note provides a detailed review of the Q2 call with analysis and context of the key issues raised. Please see the table at the end of this note for the Quarterly and LTM Altice France cash flows. Please see our research note dated 16 Aug 2023 for an overview of Altice France's capital structure.

Highlights

- Altice management is guiding that by 2025 their unconsolidated fiber to the home infrastructure subsidiary, XpFibre (Altice owns a 50.01% JV stake) will be generating in the region of €500 million in EBITDA, 90% of which will flow through to operating cash flow, after CAPEX.
- The XpFibre stake appears not to be part of creditor's collateral package.
- The Jan. 23 Term Loan amendments restrict the use of XpFibre sale proceeds/distributions.
- Management is guiding that they do not expect significant growth in net debt over the next six months. This plausibly ties into historic and forecast cash flows and means that they could need some cash injection in that time period.
- The only identified concrete source for raising €3 billion to reduce debt is the sale of the Datacenters. It's unclear whether such a sale would reduce the leverage ratio.
- It's unclear that the mooted equity injections to raise cash would not require concessions from existing debt.
- The 2025 maturities are the top priority for the buybacks.

Debt Reduction

Management emphasized that the key message of the call was their intention to reduce debt. They were clear that they intended to reduce debt by one turn of EBITDA, which they confirmed meant €4 billion. They said they were "super confident" that the debt reduction would be achieved within the next twelve months. They estimated they needed to raise approximately £3 billion to achieve a £4 billion reduction, given that Altice debt trades at a discount. However, they also emphasized that the near-term maturities, which trade closest to par, and therefore are the least discounted, were a priority for the buybacks.

The secured 2025 notes issued at the Altice France S.A. level were trading around 93 at the date of the call. The unsecured notes issued at the Altice France Holding S.A. level, the most-discounted issues in the capital structure, were trading at a weighted average price of 45 at the date of the call.

When referring to near-term maturities they intend to buy back, the Altice presentation slides refer to both the 2025 and 2026 maturities. These issues total EUR equivalent 2.331 billion comprising: 1.050 billion secured notes due 2025, 531 million of secured terms loans due 2025, and 750 million of secured term loans due 2026.

With €3 billion in cash, and assuming all the 2025 and 2026 maturities are redeemed at par and the remainder is used to redeem the unsecured notes at 50, that would reduce debt by €3.669 billion, which falls a little short but not far off the target.

During the call's Q&A session management comments made it clear the 2025 issues were the top priority. They also strongly suggested they expected to take advantage of the ability to buy their debt at a discount.

The above suggests that, after taking care of the 2025s, Altice probably plans to redeem a combination of the 2026s and the unsecured debt.

Sources of value

Management identified various sources of value available to the group to raise cash, which they described as inorganic levers. Those sources of value are:

- Selling non-core assets owned by the Altice France group including the Datacenters and other non-specified options.
- An equity injection by Patrick Drahi or selling non-specified assets from outside the Altice France group, which appears to be the same thing.
- Unspecified strategic equity or M&A options which suggests the sale of an equity stake in the group or one of its subsidiaries.
- Releasing value from Altice France's joint venture interest in XpFibre (see below).

Management also identified the following other potential steps:

- Consolidating XpFibre (see below)
- Refinancing the secured 2025 notes depending on the market

The context behind management's need to provide assurance that sources of value are available is the drop in value of the group's debt following consecutive 5% declines in quarterly EBITDA for Q1 and Q2 2023, and the fact that the group's total leverage is 6.3x and secured leverage is 5.2x.

The weighted average price of the group's unsecured notes has fallen deep into distressed territory, from 79 at the end of January, when the group successfully amended and extended 5.9 billion EUR equivalent in secured term loans, to 47 at 18 August 2023. The weighted average YTM of the group's secured notes has also weakened over the same period, from 9.3% to 12.8% with a current weighted average price of 74 at 18 August 2023.

Based on the limited public information available it appears, as would be expected, that the vast majority of the group's assets, excluding XpFibre (see below), are secured for the benefit of the debt.

Given the debt is trading at a significant discount it's reasonable to view the equity options with a degree of caution. It's not clear there is sufficient value available for an equity injection by a third party or by Patrick Drahi that would not also require some concessions from some or all the existing debt holders. The new-money equity options were left vague, and no detail was provided.

Management asserted that there was material value in XpFibre (see below). They also made it clear that it was not their preferred option to monetize their stake in XpFibre at this stage, and that it was not expected to contribute to the €3 billion being raised to reduce debt A plan B might be to lever their stake to raise cash.

The only concrete identified contributing source for the €3 billion was the sale of the datacenters. Management said discussions are ongoing regarding the Datacenters. It was hoped that the sale would be concluded in the summer, but the process was delayed by a couple weeks. The delay had no impact on the valuation that was being discussed with potential parties. It would take more than few weeks to close.

It’s not clear to what extent the sale of the Datacenters would reduce the leverage ratio given there would presumably be a negative impact on EBITDA.

Management indicated that they would provide more detail on potential options with the Q3 release and suggested that the reason they were being vague was because executing those options was commercially sensitive.

XpFibre

XpFibre’s business description and results

XpFibre is the largest alternative fiber to the home “FTTH” infrastructure wholesale operator in France. It builds and operates fiber optic networks in low and medium density areas in France. It leases capacity on its network to major French telecom providers such as Orange and Bouygues and Altice’s own subsidiary SFR. The lease agreements include upfront payments, “IRUs” which in part are used to help finance the construction of the network. The operation of FTTH networks is regulated to ensure fair competition. XpFibre describes its fiber optic network as, “neutral and open to all operators.”

At Q2 2023 XpFibre’s network had passed 6.2 million homes of which 2.8 million were in medium dense areas. The medium-term expectation is to pass 7.2 million homes. The common meaning for homes passed means premises that can be easily connected without substantial further installation. At Q2 2023 the penetration rate for the whole network was 55% and for medium dense areas it was 66%. The medium-term expectation is that penetration rates will rise above 85% given the trend to high-speed internet access and fiber optic connections. The common meaning for penetration rates is the percentage of homes passed with an active connection.

XpFibre was set up by Altice and was formerly known as SFR FTTH Network Holding. In March 2019 Altice sold a 49.99% joint venture stake in XpFibre to a consortium of investors including Allianz, AXA and OMERS. The final proceeds were €1.7 billion based on a closing equity value of €3.4 billion. At the time of the sale 1.1 million homes had been passed.

In December 2020 XpFibre’s network was expanded by XpFibre purchasing another FTTH infrastructure operator called Covage. The total cash consideration was over €1 billion of which €667 million was raised via debt on XpFibre. In July 2021, after the Covage purchase, XpFibre divested 95% of Covage’s Fiber to the office “FTTO” network in compliance with EU competition requirements imposed on the Covage acquisition.

At Q2 2023 XpFibre had €2.5 billion of debt and €300 million EBITDA. The presentation slides provide a medium-term EBITDA estimate of €600 million on revenue of €900 million.

During the call management guided that the CAPEX necessary to pass the remaining approximately one million homes would largely be incurred in 2023 with the remainder being completed in 2024. They guided that in 2025 there would be almost zero CAPEX, meaning EBITDA will convert into 90% operating free cash flow. They guided that they expected net debt to reach a maximum of €2.5 at the end of 2023 and pointed out that the interest was at a low rate of 3%. They guided that they expected EBITDA to increase by €100 million per year reaching €600 million, but potentially more in the longer term.

Management also noted that because IRU's were paid upfront but related to multi-year periods, the revenue and EBITDA associated with those IRU payments was spread over time. The result was that initially cash would be higher than EBITDA, but over time it would become lower due to the accounting treatment and the timing of IRU payments.

Management also appeared to indicate that XpFibre would be operating cash flow positive (EBITDA less CAPEX) by the end of 2023 and free cash flow positive by the end of 2024, although there was some ambiguity in the description.

Management's general message was that XpFibre was a valuable asset.

Consolidation and XpFibre's collateral and restrictive covenant status

Altice has an option to purchase between 3% and 5% of the shares of XpFibre giving it control. Management indicated that under their base case they intend to consolidate XpFibre in 2025 when the EBITDA has grown and XpFibre's leverage is expected to be lower than the group. At the present time it's higher at around 8x.

The Q1 2023 management discussion and analysis in the section relating to debt incurrence covenants at page 10 says, "The Group or its relevant subsidiaries are allowed to fully consolidate the EBITDA from any subsidiaries in which they have a controlling interest and that are contained in the restricted group…" The context suggests that consolidating a subsidiary that is not part of the restricted group would not change the leverage ratio for the purposes of the covenants.

The notice disclosure dated 23 September 2021 at page 13 defines Restricted Group as Altice France S.A. and its Restricted Subsidiaries. It defines Restricted Subsidiary as the subsidiaries of Altice France S.A. excluding Unrestricted Subsidiaries. The definition of Unrestricted Subsidiaries is just a list of subsidiaries. The notice disclosure at pages 184, 186, and 188 says that restricted subsidiaries (not capitalized) are subject to various restrictions imposed by Altice France S.A.'s credit agreements to incur additional debt, make distributions, create liens, and other restrictions, subject in some cases to leverage ratio thresholds.

The notice disclosure dated 23 September 2021 at page 14 defines XpFibre Holding and its subsidiaries as "Unrestricted Subsidiaries.". The notice disclosure dated 23 September 2021 at page 182 describes and defines the "Collateral" that secures the debt of Altice France S.A. including listing those subsidiaries with pledges over their stock. XpFibre is not included.

Based on the above it appears that as of September 2021, Altice France's 50.01% holding in XpFibre was not subject to the restrictive covenants nor the collateral package that benefits the secured debt of Altice France S.A.

More recently, the summary terms in the 19 January 2023 lender presentation, regarding the amendment and extension of €5.9 billion term loans, disclosed the following covenant change, "Asset sale proceeds (incl. shares of XpFibre) / XpFibre distributions to be applied to deleverage, unless in compliance with 3.5x net secured leverage ratio." The summary also said there was no change to the terms of the security.

The inclusion of XpFibre is consistent with the above conclusion that it's not part of the pre-existing restricted group because otherwise it likely wouldn't have been necessary to include a new covenant relating to XpFibre.

Given that XpFibre is currently not consolidated and not contributing to consolidated EBITDA it appears that despite the Jan 23 changes to the term loan covenants it remains an Unrestricted Subsidiary as described above, and its results are not included in any leverage calculations. The limited available public information means that that there is some ambiguity on this point.

The lender presentation is consistent with XpFibre continuing not to be part of the collateral package given there was no change to the security.

Due to lack of access to the actual credit documents and the need to rely on various summaries that may not be comprehensive or represent the latest terms, the above conclusions are not definitive. See our earlier article on the Altice capital structure for further details of the capital structure and leverage covenants.

Cash Flow

Managements guided that they expected to return to an improved EBITDA trend in Q4 2023 due to an expectation that service revenues would improve. They described the current market as at a standstill. They guided that they expected CAPEX for the full year to be below €2.3 billion.

They provided no guidance that things would improve in Q3. Q2 saw negative trends for both revenue (2.6%) and EBITDA (-5.7%). LTM CAPEX is already running below €2.300 billion (at €2.289 billion). Given these factors, it's not clear that there will be any improvement in operating cash flow for the full year or that there won't be further deterioration.

Management guided that interest expense for the year would increase to €1.b300 million from the current LTM figure of €1.125 billion, due to the Jan 2023 term loan amendments and floating rate exposure. They also guided that they expected a much better working capital trend in the second half of the year, mentioning items that had negatively impacted working capital in H1, without providing size.

Over the last three years working capital has always improved in H2 but on an LTM basis has been consistently negative. LTM working capital over the last two years has roughly ranged from €300 to €400 million cash outflow. The increase in interest expense will be a negative factor on the current €6 million LTM free cash flow.

Management guided on the following exceptional further outflows below free cash flow:

- Altice TV: €30 million still to be made in 2023 with further negative cash flow in 2024 and an expectation of cash flow breakeven by July 2024.
- France restructuring program: a further €71 million in 2023 and no further expenditure.
- Coriolis Acquisition: final instalment of €65 million in 2024.
- Spectrum: €118 million final payment still to be made in 2023.

The above suggests a further €219 million cash expense below free cash flow in 2023 and at least €65 million in 2024.

Management guided that from 2024 onwards they expected no significant cash items below operating cash flow other than interest expense. This suggests a material turnaround in the LTM working capital trend over the longer term.

In the shorter term they guided that a significant growth in net debt over the next six months should not be expected. This seems possible due to the €219 million exceptional cash expense plus the increased interest expense being offset or partially offset against the seasonally improved operating cash flow and working capital.

This of course does not address the longer-term issue of refinancing Altice France's debt at higher interest rates.

Please see the table at the end of this note for the group's quarterly and LTM cash flows.

Altice France Holding Restricted Group Results

Revolving Credit Facilties	Q2 2023	Q1 2023	Q4 2022	Q3 2022	Q2 2022	Q1 2022	Q4 2021	Q3 2021
Pro-Forma Drawn	120	0	138	325	465	190	0	381
Pro-Forma Undrawn	1086	1206	1068	881	741	1016	1206	825
Total Commitments	1206	1206	1206	1206	1206	1206	1206	1206

LTM Cash Flow	**Q2 2023**	**Q1 2023**	**Q4 2022**	**Q3 2022**	**Q2 2022**	**Q1 2022**	**Q4 2021**	**Q3 2021**
% Change	**-0.7%**	**0.1%**	**-0.1%**	**0.8%**	**1.1%**	**0.3%**	**0.0%**	
Revenue	11,233	11,307	11,300	11,314	11,223	11,101	11,070	11,067
% Change	**-1.5%**	**-1.2%**	**0.0%**	**0.1%**	**0.0%**	**-0.8%**	**-2.3%**	
EBITDA	3,990	4,052	4,101	4,100	4,096	4,094	4,127	4,226
CAPEX	(2,289)	(2,331)	(2,365)	(2,448)	(2,456)	(2,385)	(2,343)	(2,481)
Operating Cash Flow	1,701	1,721	1,736	1,652	1,640	1,709	1,784	1,745
Hivory OpFCF	0	0	0	20	64	94	118	98
Interest	(1,125)	(1,091)	(1,043)	(990)	(1,025)	(946)	(1,077)	(1,010)
Taxes	(133)	(105)	(100)	(67)	(74)	(64)	(74)	(92)
Changes in WC & Other	(437)	(418)	(352)	(436)	(330)	(298)	(423)	(137)
Free Cash Flow	6	107	241	179	275	495	328	604
Spectrum	(144)							
Restructuring, IRU & M&A	(273)							
Altice TV	(70)							
Other Financing & Other	(80)							
Change in net debt	(561)							

Quarterly Cash Flow	**Q2 2023**	**Q1 2023**	**Q4 2022**	**Q3 2022**	**Q2 2022**	**Q1 2022**	**Q4 2021**	**Q3 2021**	**Q2 2021**	**Q1 2021**	**Q4 2020**
% Change	-2.60%	0.26%	-0.48%	3.36%	4.48%	1.15%	0.10%				
Revenue	2,769	2,740	2,926	2,798	2,843	2,733	2,940	2,707	2,721	2,702	2,937
% Change	-5.7%	-5.4%	0.1%	0.4%	0.2%	-3.5%	-8.6%				
EBITDA	1,022	857	1,057	1,054	1,084	906	1,056	1,050	1,082	939	1,155
Accrued CAPEX	(552)	(589)	(592)	(556)	(594)	(623)	(675)	(564)	(523)	(581)	(813)
Operating Cash Flow	470	268	465	498	490	283	381	486	559	358	342
Hivory OpFCF	0	0	0	0	0	0	20	44	30	24	0
Interest	(351)	(245)	(314)	(215)	(317)	(197)	(261)	(250)	(238)	(328)	(194)
Taxes	(50)	(10)	(42)	(31)	(22)	(5)	(9)	(38)	(12)	(15)	(27)
Changes in WC & Other	(93)	(247)	78	(175)	(74)	(181)	(6)	(69)	(42)	(306)	280
Free Cash Flow	(24)	(234)	187	77	77	(100)	125	173	297	(267)	401
Spectrum	0	0	(144)	0							
Restructuring, IRU & M&A	(103)	(30)	(21)	(119)							
Altice TV	0	(70)	0	0							
Other Financing & Other	(145)	(108)	42	131							
Change in net debt	(272)	(442)	64	89							

Leverage Ratio	**Q2 2023**	**Q1 2023**	**Q4 2022**	**Q3 2022**	**Q2 2022**	**Q1 2022**	**Q4 2021**	**Q3 2021**	**Q2 2021**	**Q1 2021**	**Q4 2020**
Restricted Group Gross Debt	24,158	24,121	23,666	23,617	23,582	23,195	23,065	23,399	22,776	22,641	22,393
Cash	297	480	301	356	249	1	52	422	365	436	542
Restricted Group Total Net Debt	23,861	23,641	23,365	23,261	23,333	23,194	23,013	22,977	22,411	22,205	21,851
Restricted Group Secured Net Debt	19,670	19,450	19,183	19,080	19,135	18,900	18,721		18,059	17,919	17,569
L2QA EBITDA Pro-Forma	3,759	3,829	4,223	4,288	4,026	3,993	4,281	4,332	4,042	4,090	4,478
Restricted Group Total Net Debt leverage L2QA	6.3	6.2	5.5	5.4	5.8	5.8	5.4	5.3	5.5	5.4	4.9
Restricted Group Secured Net leverage L2QA	5.2	5.1	4.5	4.4	4.8	4.7	4.4	0.0	4.5	4.4	3.9

Source: Altice France Holding Restricted Group quarterly results presentation slides