

Rating Action: Moody's changes Rai's outlook to negative

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Madrid, October 22, 2019 -- Moody's Investors Service ("Moody's") has today changed to negative from stable the outlook on the ratings of RAI -- Radiotelevisione Italiana S.p.A. (Rai). Concurrently, Moody's has affirmed Rai's Baa3 long-term issuer rating and the Baa3 senior unsecured rating on Rai's EUR350 million notes due in May 2020.

"The change in outlook to negative reflects the substantial deterioration in Rai's key credit metrics relative to our previous expectations, as a result of a lower than anticipated allocation of over-budget proceeds from licence fees to Rai, large investments in business digitalization and incremental content costs related to upcoming sports events," says Víctor García Capdevila, a Moody's AVP-Analyst and lead analyst for Rai.

"As a result, we expect Rai to generate negative free cash flow over the next two years, with a debt increase that will push leverage to around 5.7x in 2020, which positions the company weakly in the Baa3 rating category," adds Mr García.

A full list of affected ratings is provided towards the end of this press release.

RATINGS RATIONALE

Rai's ambitious strategic plan for 2019-21 is focused on the digitalization of its business model in order to remain relevant in a rapidly and structurally changing media sector. Over the last few years, the traditional media sector has undergone a rapid shift towards non-linear content models, particularly online platforms and mobile, and away from traditional TV. This structural change is even more acute amongst younger, and more profitable, audiences. Furthermore, the digitalization of the media landscape is enabling large and well capitalized online players to enter the traditional media space intensifying the competitive environment.

Rai needs to adapt its offering to the shift in consumer preferences while it continues to meet existing and new requirements under the service contract such as extending the television offer with new English channels, investing in the development of original formats, redesigning and strengthening its radio offering and adapting the digital terrestrial television (DTT) transmission infrastructure for the 700MHz frequency refarming due in 2022.

In order to transform the business from a pure traditional broadcaster into a more digitally oriented multiplatform media company, Rai will need to invest a considerable amount of money over the next three years. Moody's has assumed an investment in digitalization of around €270 million to €300 million and about €100 million to strengthen its product offering from 2019 through 2021. The company has identified a number of self-help initiatives to help fund the investments; these are mainly related to potential efficiencies and organizational changes which Moody's estimates at around €130 million. However, a large part of the investment plan will be funded through additional debt. This coupled with a revenue shortfall of around €100 million in 2019 due to the change in the split between Rai and the Italian government of over budget receipts from license fees, results in a considerable deterioration in the company's key credit metrics relative to previous expectations. The rating agency expects Rai's gross leverage, as adjusted by Moody's, to increase towards 4.6x and 5.7x in 2019 and 2020, respectively, from 3.6x in 2018. Moody's also expects leverage to decrease towards 3.8x in 2021 mainly due to the absence of significant content costs during that year.

In line with the Government-Related Issuers (GRI) methodology, Rai's Baa3 rating reflects the combination of a baseline credit assessment (BCA) of ba1, the Baa3 domestic currency rating of the Government of Italy, the very high dependence between Rai and the Italian sovereign and Moody's expectations of strong support from the sovereign.

Rai's ba1 BCA reflects (1) the recurrence and stability of the company's revenue, 68% of which is generated through licence fee payments (Canone) by Italian households; (2) its strong position in Italy as the leading broadcaster, with a whole day audience share of 36.3%; and (3) the stable regulatory framework. The BCA also factors in (1) a considerable increase in Moody's adjusted gross leverage towards 5.7x in 2020; (2) its weak free cash flow generation, and (3) an expected deterioration in key credit metrics over the next two years

as a result of the investments needed to implement the 2019-2021 business plan.

Rai's liquidity is adequate, supported by a cash balance of €227 million at June 2019 and a fully available committed revolving credit facility of €320 million. The company also has access to uncommitted bank facilities for a total amount of €420 million. Moody's expects Rai to generate negative free cash flows of around €170 million in 2019 and €90 million in 2020. The company has a €350 million bond maturity in May 2020. Moody's expects that Rai will successfully refinance its approaching bond maturity in the coming months, while maintaining adequate liquidity at all times.

The rating also considers the following environmental, social and governance (ESG) factors. Evolving demographic and societal trends are Rai's key social risks. The rise of new wireless communications technologies such as smartphones and tablets are driving changes and also influence consumer behavior and advertising. Over-the-top (OTT, internet streaming services) channels have broken television broadcaster's stronghold on distribution content, forcing broadcasters such as Rai to adapt to the new environment as they aspire to remain relevant with the audiences. In terms of governance, Rai's is almost wholly owned (99.56%) by the Italian Ministry of Economy and Finance. This strong link with the government has positive and negative credit considerations. Its status of public broadcaster provides the company with a stable and highly visible revenue stream through the Canone. However, Rai's objectives are geared away from profit generation, and as such, its profitability, metrics and liquidity management are weaker than those of commercial broadcasters. In addition, active government involvement in Rai's day-to-day operations (outside of the appointed board members' influence) may have a negative impact on the business, such as decisions on the allocation of revenue exceeding forecasts between the Government and Rai.

RATIONALE FOR NEGATIVE OUTLOOK

The negative outlook reflects Moody's expectation of a substantial deterioration in the company's key credit metrics in 2019 and 2020, and while leverage in 2021 may improve because of the absence of large investment costs, visibility on this potential recovery is relatively low.

WHAT COULD CHANGE THE RATING UP / DOWN

Given the change in outlook to negative from stable, upward pressure on Rai's rating is unlikely unless there is an upgrade of the sovereign rating.

The following factors could exert downside pressure on Rai's rating: (1) a downgrade of the sovereign rating or outlook; (2) a sustained deterioration in operating performance owing to material erosion of Rai's TV audience market share, a significant decline in advertising revenues or an increase in investments (costs and capex) that put further pressure on free cash flow generation; (3) actions by the government that weaken the standalone financial profile of Rai; or (4) a deterioration in Rai's liquidity profile.

LIST OF AFFECTED RATINGS

..Issuer: RAI - Radiotelevisione italiana S.p.A.

Affirmations:

.... LT Issuer Rating, Affirmed Baa3

....Senior Unsecured Regular Bond/Debenture, Affirmed Baa3

Outlook Action:

....Outlook, Changed To Negative From Stable

PRINCIPAL METHODOLOGIES

The methodologies used in these ratings were Media Industry published in June 2017, and Government-Related Issuers published in June 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

COMPANY PROFILE

Headquartered in Rome, RAI - Radiotelevisione italiana S.p.A. (Rai) is the exclusive public broadcasting service provider in Italy, where it operates TV, radio and internet channels. Rai has remained the market leader

in TV broadcasting in Italy, with a 36.3% whole-day audience share. Rai is owned by the government through the Ministry of Economy and Finance, which directly holds 99.56% of the company.

In 2018, Rai reported revenue of €2.6 billion and EBITDA of €585 million.

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