Colombia Telecomunicaciones S.A. E.S.P

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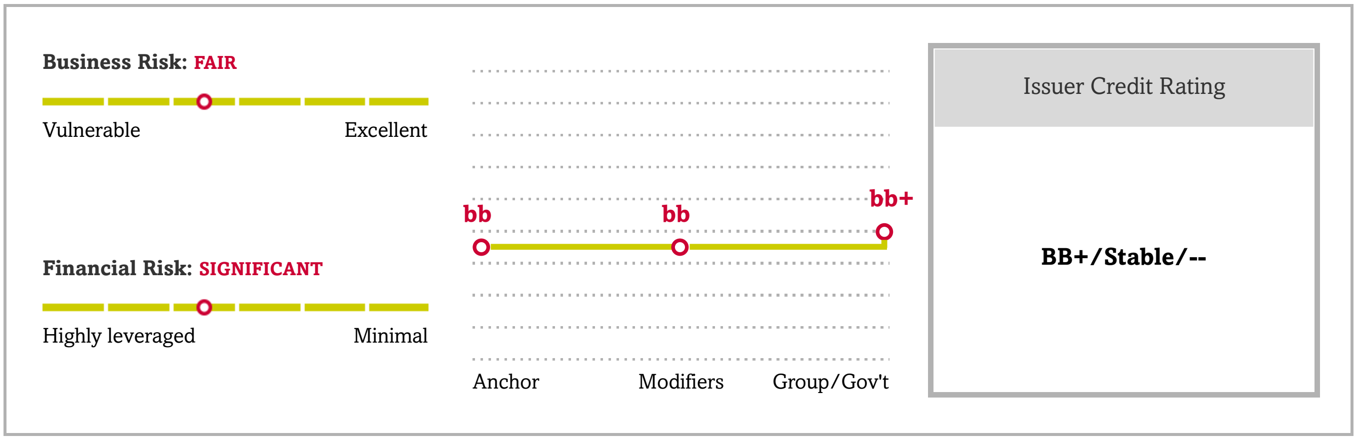
Table Of Contents

Table Of Contents (cont.)

Colombia Telecomunicaciones S.A. E.S.P

*(**Editor's Note:** Financial metrics and calculations adjusted by S&P Global according to its "Corporate Methodology: Ratios And Adjustments," published April 1, 2019.)*



Credit Highlights

Overview

Key strengths	Key risks
Second largest player in Colombia's mobile market and third largest player in broadband and fixed voice markets.	Aggressive competition in Colombian telecomm and cable industry.
EBITDA margins in line with the industry, positioning Coltel as the second-largest player in telecom market in Colombia.	Geographic concentration in the Colombian market.
Prudent capital expenditures (capex) leading to strong free operating cash flow (FOCF) generation.	Heavy industry-wide capital intensity for network deployment.
Smooth debt maturity profile after the company's short-term debt refinancing.	

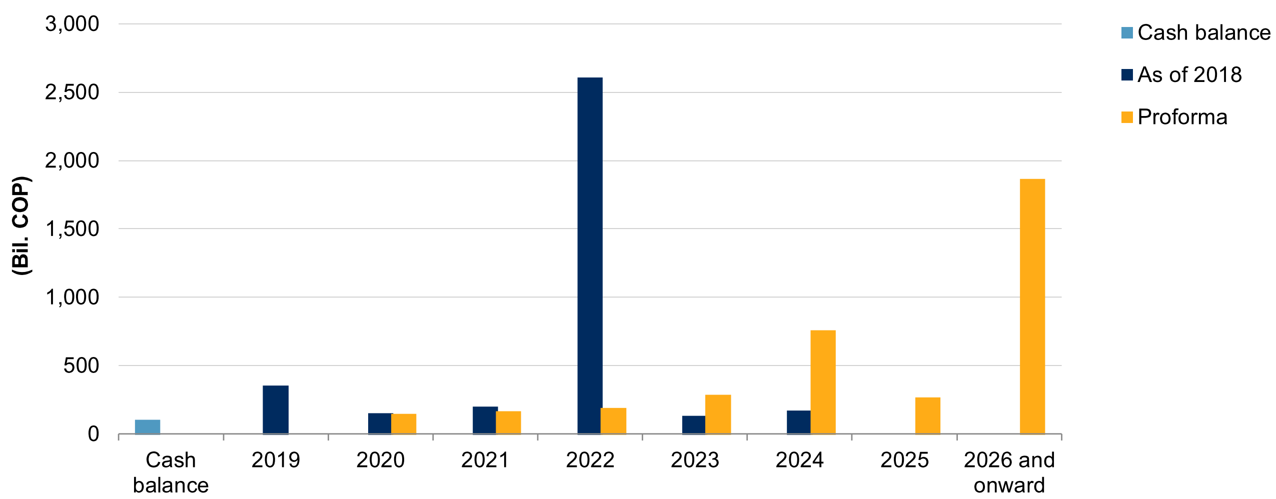
Coltel's growth strategy focuses on mitigating aggressive competitive environment in Colombian telecom and cable industry Starting in 2019 onward, the company is implementing new growth plans aiming to grow its customer base and operating efficiencies and maintain its position within the Colombian telecomm industry. Colombia Telecomunicaciones S.A. E.S.P's (Coltel) "#RECONECTA" strategy involves commercial efforts to incorporate households allocated within its network connectivity through fiber to the home (FTTH) and triple-play packages. In addition, we expect the company to maximize operating costs as current installed capacity continues increasing productivity through a larger customer base. These factors will allow the company to continue its low pricing plans to retain and increase its customer base in the next two years.

New technology in telecomm services and goal of more network coverage. The company's operational plans include aligning its capex amount with operational performance, measured through consolidation of its current installed capacity. Technology in the industry keeps evolving, leading to new connectivity solutions such as the 4.5G network. Thus, in our base-case scenario we expect the company to maintain sufficient cash generation in order to continue investing in technological updates and increasing its FTTH network coverage by the end of the year.

Expected completion of debt refinancing strategy while focusing on operations. In our base-case scenario, we expect Coltel to complete its COP500 billion local market issuance by the second quarter of this year. This issuance, in addition to the restructuring of current bank loans, will expand the company's maturity schedule, increase availability in local bank loans, and diversify financing sources. By 2020, we also estimate the company will have an additional refinancing plan for its $750 million unsecured senior bond due 2022. These debt refinancings will benefit from an expected rise in cash flows for the next two years thanks to the gradual improvements in revenues and stable EBITDA margins; while Coltel maintains capex flexibility. Coltel's weighted-average maturity for its long-term debt is around four years as of the end of 2018, and 8.4 years on a pro-forma basis after the refinancing strategy in 2019 and 2020.

Chart 2

Coltel's Debt Maturities As Of 2018 and Pro Forma



COP--Colombian peso.

Outlook: Stable

The stable outlook reflects our expectation that Coltel will maintain its position as the second-largest wireless player in Colombia thanks to its planned LTE deployment and its "#RECONECTA" strategy, which will increase the company's share in the fixed-line and broadband markets. This, along with higher cash flows due to a lower debt burden, should enable the company to post debt to EBITDA and funds from operations (FFO) to debt metrics of about 2.3x and between 30% and 45%, respectively, in the next 12-18 months.

Downside scenario

We could lower our ratings in the next 12-18 months if the company's results fall below our expectations, resulting in debt to EBITDA and FFO to debt above 3.0x and below 30%, respectively, on a consistent basis. This could result from intense competition that would prompt Coltel to reduce prices in order to retain its market position or if it were to pursue a debt-financed acquisition.

Upside scenario

We could upgrade Coltel in the next 12-18 months if it posts debt to EBITDA and FFO to debt consistently below 2.0x and at or above 45%, respectively, along with EBITDA margins around 35% that reflect a stronger competitive position.

Our Base-Case Scenario

Assumptions

- We forecast Colombia's GDP growth of about 2.9% for 2019 and 3.0% for 2020. We expect a compound annual growth rate (CAGR) of about 3.7% for the fixed telecomm market and 3.6% for the mobile market. We believe that Colombia's economic stability will support the industry's steady growth rate for the next two years.
- Average exchange rate of COP3,050 per $1 for both 2019 and 2020. For 2019, the company holds a non-delivery forward instrument to cover the unsecured senior bond's outstanding amount, dollar-denominated expenses, and cash and equivalents.
- Revenue growth of 8.5% for 2019 and 4.3% for 2020, mainly due to Coltel executing its #RECONECTA strategy that focuses on growing the customer base, better connectivity, paid-TV content strategic partnerships, and expanding its mobile virtual network operator (MVNO) services in the country.
- Working capital requirements of COP118.6 billion for 2019 and COP101.0 billion for 2020.
- Capex of around COP1.8 trillion for the next two years, mainly for fiber optic deployment, 4G/4.5G improvements, and 20% of its spectrum license renewal down payment.
- Hybrid-related dividend payments of COP180 billion in the next two years.
- Issuance of a senior unsecured bond for COP500 billion in local markets this year, primarily for its debt refinancing plan.

Key Metrics

	2018A	2019E	2020E
EBITDA* margins (%)	29.7	26.4	26.5
Debt to EBITDA (x)	2.5	2.4	1.7
FFO to debt (%)	33.4	29.0	43.8
FOCF to debt (%)	7.8	9.2	21.1

A--Actual. E—Estimate.

*EBITDA -- Revenue minus operating expenses (excluding depreciation, amortization, and non-current asset impairment and impairment reversals). We eliminate gain/loss on disposals of PP&E.

Base-case projections

Coltel's margins expected to stabilize in the next two years. We estimate that EBITDA margins will drop to about 26.5% in 2019 and 2020, stabilizing from then onward due to operating efficiencies. These margins are below Coltel's 29.7% margin last year because we expect market competition to increase during 2019.

Leverage to gradually decrease. Expected debt will continue its downward trend as Coltel completes its refinancing strategy and tower sale and leaseback agreements in 2019. Therefore, debt to EBITDA is likely to fall to about 1.7x by 2020.

Capital expenditures' intensity to align on operating performance. In order to maintain cash generation, we believe Coltel will keep capex flexible and aligned with its current installed capacity. Maximization on operating costs is likely to make the company's FOCF to debt ratio rebound up to 21.1% by 2020.

Company Description

Coltel is an integrated telecommunications provider that operates under the trademark Movistar. It's been part of the Telefonica group since 2006. In 2012, Coltel merged with Telefonica Moviles Colombia S.A. As of 2018, Telefonica S.A. (TEF; BBB/Stable/A-2) owns 67.5% of Coltel and the Colombian government owns the rest. Coltel provides fixed telephony, mobile telephony, Internet, broadband, data transmission services, satellite television, and corporate solutions (such as data centers and IT services).

Business Risk: Fair

Coltel's business risk profile primarily reflects its market shares in the fixed-line (23.2% share) and mobile (24.0% share) services, as well as its lower share in pay-TV services (9.6% share) in Colombia. By the end of last year, the company reached 17.6% of FTTH coverage of the 522,000 pass through homes; and 24.0% of 4G coverage total market. In addition, its operations reflect a churn rate of about 1.8%, slightly below the industry's average of 2.0%. Sales behavior usually maintains lower churn rates through increasing subscriptions with more than one service, as customers seek price benefits. Lower churn rates tend to maximize operating costs.

The company's business risk profile is supported by its EBITDA margins of close to 30.0% for 2018, with an expected average of 28.0% the upcoming three years, translating into higher cash generation. Coltel's strategy includes new low-cost commercial packages that have more attractive network connectivity services and internet plans. Through this strategy, Coltel has managed to increase consistently its customer base and, simultaneously, to maximize operating costs by diversifying the products and services it offers. However, the company has highly concentrated operations, but it remains the second-largest player in telecom market in Colombia.

The increase in market competition has resulted in the company's continuous changing operational growth strategy, leading to constant modifications on commercial package offers and pricing to retain and attract customers given the competitive conditions. For the next three years, we expect Coltel's average revenue to grow 4.1% on postpaid and 1.9% for prepaid services, through its lower-cost strategy (mostly, triple-play services).

Lastly, Coltel is currently deploying its #RECONECTA plan. We still view Coltel's operating efficiency as adequate given the continuous effort and improvement in cost reduction and customer attraction strategies.

Peer comparison

Table 1

Colombia Telecomunicaciones, S.A. E.S.P. -- Peer Comparison

Industry Sector: Telecom & Cable

	Colombia Telecomunicaciones, S.A. E.S.P.	CenturyLink Inc.	Kazakhtelecom JSC	Axtel S.A.B. de C.V.
Rating as of Apr. 8, 2019	BB+/Stable/--	BB/Stable/--	BB+/Stable/--	BB/Stable/--

Table 1

Colombia Telecomunicaciones, S.A. E.S.P. -- Peer Comparison (cont.)

	--Fiscal year ended Dec. 31, 2018--	--Fiscal year ended Dec. 31, 2018--	--Fiscal year ended Dec. 31, 2017--	--Fiscal year ended Dec. 31, 2018--
(Mil. $)				
Revenues	1,685.0	23,443.0	631.7	650.8
Adjusted EBITDA	500.3	9,282.5	232.1	267.6
FFO	418.5	6,229.8	180.8	156.8
Net income from continuing operations	119.8	(1,733)	74.3	(51.2)
Cash flows from operations	343.6	7,461.8	186.1	330.4
Capital expenditures	245.4	3,122.0	63.1	95.2
Free operating cash flow	98.2	4,339.8	123.0	235.2
Discretionary cash flow	117.1	2,027.8	123.0	235.2
Cash and short-term investments	38.1	488.0	223.8	114.5
Debt	1,254.3	41,568.2	85.4	980.3
Equity	1,821.2	19,828.0	1,079.1	184.3
Adjusted ratios				
EBITDA margin (%)	29.7	39.6	36.7	41.1
Return on capital (%)	2.9	5.5	9.7	3.8
EBITDA interest coverage (x)	2.9	3.9	9.7	2.5
FFO cash interest coverage (X)	3.0	3.6	8.6	2.7
Debt/EBITDA (x)	2.5	4.5	0.4	3.7
FFO/debt (%)	33.4	15.0	211.7	16.0
Cash flow from operations/debt (%)	27.4	18.0	217.9	33.7
Free operating cash flow/debt (%)	7.8	10.4	144.1	24.0
Discretionary cash flow/debt (%)	6.3	4.9	144.1	24.0

FFO--Funds from operations.

Among our selected peers in the 'BB' category, Coltel ranks second in terms of revenue and market share. However, we believe that high competition could keep affecting EBITDA margins, compared to peers that either have stable profitability (CenturyLink) or have divested unprofitable business segments (Axtel). Coltel's leverage strategy consists of adjusting capex intensity until it reaches an adequate use of installed capacity, leading the company to reduce debt levels, which we view as a strength compared to peers. We expect Coltel to maintain debt to EBITDA ratios close to 2.0x and free operating cash flow (cash flow from operations net of capex) equivalent to 20%-30% of debt for the next two years.

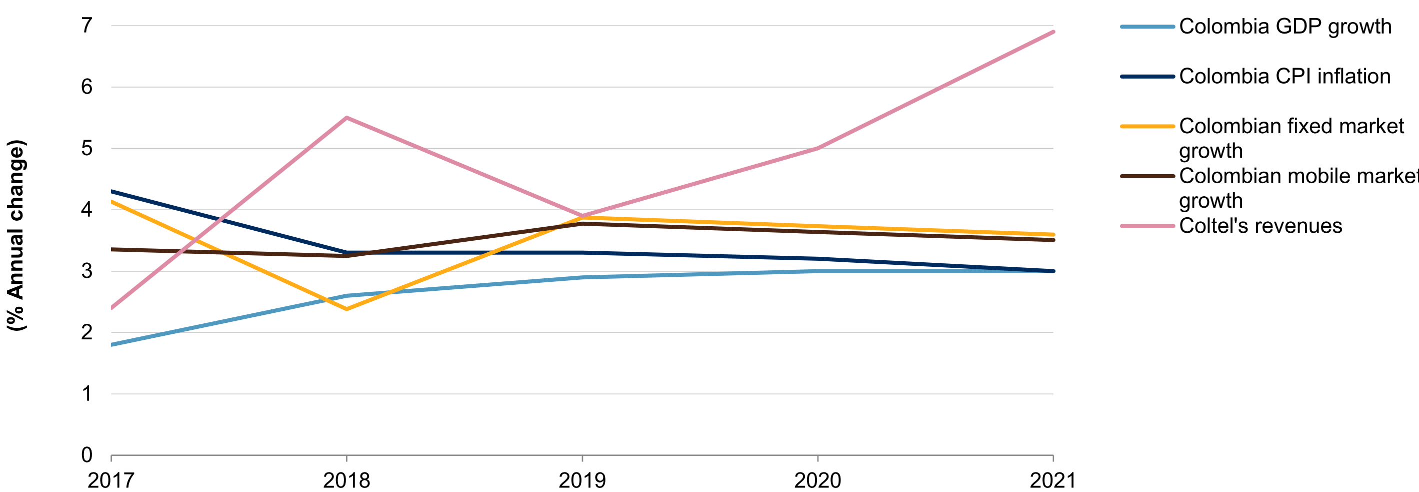
Financial Risk: Significant

At the end of 2018, Coltel reported a debt-to-EBITDA ratio of 2.5x from our previous estimate of 2.3x. As mentioned, increasing competition drove the company to increase commercial expenses to market its renewed packages that included higher benefits for customers at a lower price. We consider that the company was able to maintain its cost and expenses burden in line with the previous year's results. Despite weaker-than-expected EBITDA, we consider Coltel's leverage metrics to be commensurate with the rating. This is supported by the company's conservative financial discipline--its debt is only related to working capital requirements. We expect the company to deleverage gradually, with debt to EBITDA at 1.7x and FOCF to debt at 21.1% by 2020.

Our base-case scenario assumes that Coltel's revenues will rebound to approximately 5.0% growth (eliminating extraordinary funds from tower sales) in 2019 and 2020, as it aims to increase customer base through triple-play packages, higher FTTH connectivity, and stronger relationships with the main international carriers for MVNO services. We also expect an EBITDA margin of around 26.5% for the next two years as the company continues maximizing costs and consolidation of its current installed capacity.

Chart 3

Coltel's Revenues And Economic Growth



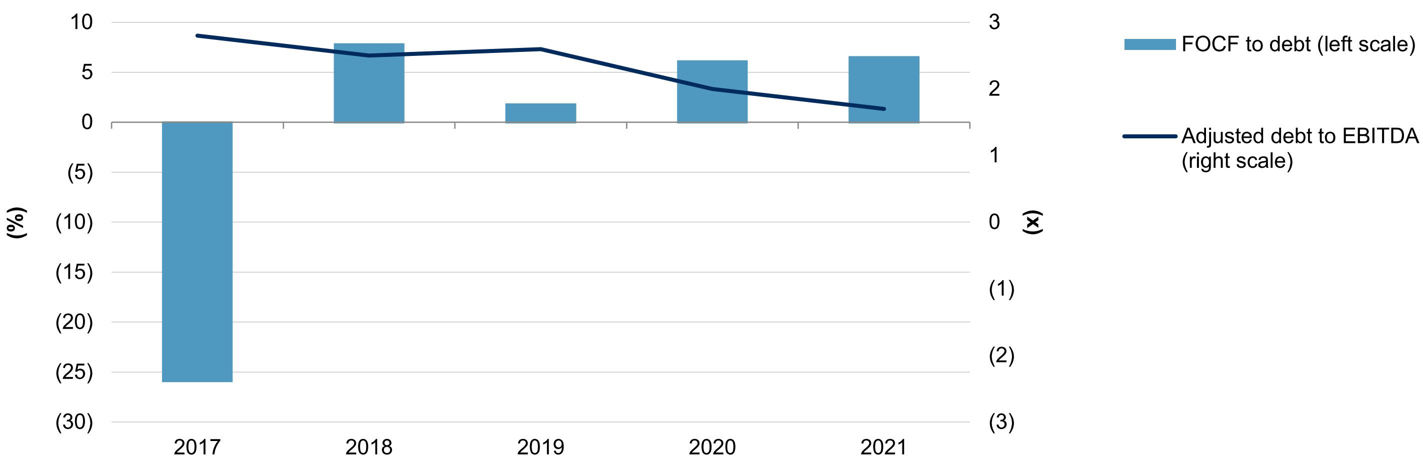
CPI--Consumer price index.

The company continues to deleverage after it paid down liabilities after receiving funds from the sale of towers. We expect the company to complete its refinancing strategy through 2019 and 2020, releasing short-term maturity exposures while focusing on operational strategies to face higher competition. We expect Coltel's debt to be about COP3.9 billion in 2019 and COP2.8 billion in 2020.

We believe FOCF will increase gradually in 2019 and 2020 primarily due to the company's flexible capex. In addition, the company continues to sell tower sites and PARAPAT's fixed assets that will benefit its cash generation, according to our projections, by about COP900 million in the next two years. Lastly, we expect the company to continue its dividend payments related to the hybrid securities. This translates into FOCF to debt of 9.2% and 21.1% for 2019 and 2020, respectively.

Chart 4

Adjusted Debt-To-EBITDA And DCF-To-Debt Ratios



DCF--Discretionary cash flow.

Financial summary

Table 2

Colombia Telecomunicaciones, S.A. E.S.P. -- Financial Summary

Industry Sector: Telecom & Cable

	--Fiscal year ended Dec. 31--					
(Bil. COP)	**2018**	**2017**	**2016**	**2015**	**2014**	**2013**
Revenues	5,470.7	5,010.0	4,871.6	4,681.1	4,555.0	4,200.8
EBITDA	1,624.3	1,510.4	1,500.8	1,583.3	1,599.7	1,289.9
FFO	1,358.8	855.4	281.0	327.6	1,599.7	1,289.9
Net income from continuing operations	388.9	299.8	(341.3)	60.5	828.9	(262.0)
Cash flow from operations	1,115.6	954.5	562.2	671.7	1,169.2	872.5
Capital expenditures	796.8	2,054.5	949.3	937.0	827.9	625.5
Free operating cash flow	318.8	(1,100.1)	(387.1)	(265.3)	341.3	247.0
Discretionary cash flow	257.5	(1,162.3)	(460.8)	(303.5)	341.3	247.0
Cash and short-term investments	123.7	316.4	214.7	292.5	164.4	143.8
Debt	4,072.5	4,239.9	8,148.4	7,647.2	8,087.7	3,486.0
Equity	5,912.9	5,765.4	(1,000.0)	(421.1)	(1,488.2)	1,131.2
Adjusted ratios						
EBITDA margin (%)	29.7	30.1	30.8	33.8	35.1	30.7

Table 2

Colombia Telecomunicaciones, S.A. E.S.P. -- Financial Summary (cont.)

Industry Sector: Telecom & Cable

	--Fiscal year ended Dec. 31--					
(Bil. COP)	**2018**	**2017**	**2016**	**2015**	**2014**	**2013**
Return on capital (%)	2.9	4.1	7.4	9.1	9.6	1.9
EBITDA interest coverage (x)	2.9	2.2	1.5	1.8	N.M.	N.M.
FFO cash interest coverage (x)	3.0	2.2	1.3	1.4	N.M.	N.M.
Debt/EBITDA (x)	2.5	2.8	5.4	4.8	5.1	2.7
FFO/debt (%)	33.4	20.2	3.4	4.3	19.8	37.0
Cash flow from operations/debt (%)	27.4	22.5	6.9	8.8	14.5	25.0
Free operating cash flow/debt (%)	7.8	(25.9)	(4.8)	(3.5)	4.2	7.1
Discretionary cash flow/debt (%)	6.3	(27.4)	(5.7)	(4.0)	4.2	7.1

FFO--Funds from operations. N.M.-- Not meaningful.

Liquidity: Adequate

We view Coltel's liquidity as adequate because we forecast the company's sources over uses of cash to be above 1.2x and that sources will be greater than uses even if EBITDA were to decline 15% from our base-case scenario over the next 12 months. Our liquidity assessment includes Coltel's good relationships with banks and its generally satisfactory standing in the international debt markets.

Principal Liquidity Sources	Principal Liquidity Uses
• Cash and liquid investments of COP 124 billion as of Dec. 31, 2018. • Projected FFO of about COP 1.6 trillion in the next 12 months.	• Short-term debt amortizations of about COP347 billion over the next 12 months. • Working capital outflows of about COP119 billion over the next 12 months. • Maintenance capex of about COP635 billion in the next 12 months. • Hybrid dividend payments of about COP128 billion during 2019.

Debt maturities

Debt maturities of about COP347 billion over the next 12 months primarily include short-term amortizations from bank loans, issued to cover working capital requirements. Coltel's weighted-average maturity for its long-term debt is about four years at the end of 2018, and 8.4 years on a pro-forma basis after its refinancing strategy in 2019 and 2020.

Covenant Analysis

Coltel is only subject to its senior notes leverage covenant that consists of maintaining less than 3.75x net debt to EBITDA until the notes mature in 2022.

Compliance Expectations

Based on our assumptions, our base-case scenario suggests that the company will not breach its leverage threshold in the next 12 months. Moreover, the company aims to its debt refinancing plans.

Group Influence

TEF owns 67.5% of Coltel. We view Coltel as moderately strategic for the parent company because we believe that TEF is unlikely to sell it in the next year or so, it's reasonably successful within the telecom industry and it's likely to receive support from Telefonica if needed. Thus, the ratings on Coltel incorporate a one-notch uplift from its 'bb' stand-alone credit profile (SACP).

Government Influence

Coltel is 32.5% government-owned. We believe there is a low likelihood of timely and sufficient extraordinary support from the government to Coltel in the event of financial distress, because the government intends to sell its stake in Coltel. Our ratings on Coltel don't incorporate any government support.

Ratings Score Snapshot

Issuer Credit Rating

BB+/Stable/--

Business risk: Fair

- **Country risk:** Moderately high
- **Industry risk:** Intermediate
- **Competitive position:** Fair

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:** Fair (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bb

- **Entity status within group:** Moderately strategic (+1 notch from SACP)
- **Likelihood of government support:** Low (no impact)

Issue Ratings--Subordination Risk Analysis

Capital structure

Coltel's capital structure consists of $750 million senior unsecured notes, hybrid securities, and debt with credit institutions.

Analytical conclusions

The company doesn't have subsidiaries and only has debt at its level, so we believe there is no applicable subordination.

Our 'BB-' on Coltel's hybrid securities incorporates:

- A one-notch deduction for subordination because the ICR on Coltel is speculative grade;
- An additional one-notch deduction for payment flexibility to reflect the optional nature of the deferral interest.

Reconciliation

Table 3

Reconciliation Of Colombia Telecomunicaciones S.A. E.S.P Reported Amounts With S&P Global Ratings' Adjusted Amounts (Bil. COP)

	--Fiscal year ended Dec. 31, 2018--									
	Debt	Shareholders' equity	Revenues	EBITDA	Operating income	Interest expense	S&P Adjusted EBITDA	Cash flow from operations	Dividends	Capital expenditures
Colombia Telecomunicaciones S.A. E.S.P reported amounts										
	3,568.0	6,544.2	5,470.7	1,833.9	484.8	223.8	1,624.3	1,176.9	-	796.8
S&P Global Ratings' adjustments										
Cash taxes paid	-	-	-	-	-	-	(213.3)	-	-	-
Cash interest paid	-	-	-	-	-	-	(493.3)	-	-	-
Intermediate hybrids reported as equity	639.2	(639.2)	-	-	-	-	(61.3)	(61.3)	(61.3)	-
Accessible cash and liquid investments	(123.7)	-	-	-	-	-	-	-	-	-

Table 3

Reconciliation Of Colombia Telecomunicaciones S.A. E.S.P Reported Amounts With S&P Global Ratings' Adjusted Amounts (Bil. COP) (cont.)

Non-operating income (expense)	-	-	-	-	19.8	-	-	-	-	-
Non-controlling interest/Minority interest	-	7.9	-	-	-	-	-	-	-	-
Debt - Derivatives	(11.0)	-	-	-	-	-	-	-	-	-
EBITDA - Gain/(Loss) on disposals of PP&E	-	-	-	(209.5)	(209.5)	-	-	-	-	-
Total adjustments	504.5	(631.3)	-	(209.5)	(189.7)	-	(767.9)	(61.3)	(61.3)	-
S&P Global Ratings' adjusted amounts										
	Debt	**Shareholders' equity**	**Revenues**	**EBITDA**	**Operating income**	**Interest expense**	**S&P Adjusted EBITDA**	**Cash flow from operations**	**Dividends**	**Capital expenditures**
	4,072.5	5,912.9	5,470.7	1,624.3	295.0	223.8	856.4	1,115.6	(61.3)	796.8

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology And Assumptions: Assigning Equity Content To Hybrid Capital Instruments Issued By Corporate Entities And Other Issuers Not Subject To Prudential Regulation, Jan. 16, 2018
- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Telecommunications And Cable Industry, June 22, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	**bb**	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of May 3, 2019)*

Colombia Telecomunicaciones S.A. E.S.P	
Issuer Credit Rating	BB+/Stable/--
Senior Unsecured	BB+
Subordinated	BB-
Issuer Credit Ratings History	
07-Sep-2017	BB+/Stable/--
02-Aug-2017	BB/Watch Neg/--
04-Aug-2016	BB/Negative/--
Related Entities	
Telefonica Brasil S.A.	
Issuer Credit Rating	
Brazil National Scale	brAAA/Stable/--
Senior Unsecured *Brazil National Scale*	brAAA
Telefonica Chile S.A.	
Issuer Credit Rating	BBB/Stable/--
Senior Unsecured	BBB
Telefonica Emisiones S.A.U.	
Issuer Credit Rating	BBB/Stable/--
Telefonica Europe B.V.	
Issuer Credit Rating	BBB/Stable/--
Telefonica Finanzas Mexico S.A. de C.V.	
Senior Unsecured *CaVal (Mexico) National Scale*	mxAA+
Telefonica Moviles Chile S.A.	
Issuer Credit Rating	BBB/Stable/--
Telefonica Participaciones S.A.U.	
Issuer Credit Rating	BBB/Stable/--
Telefonica S.A.	
Issuer Credit Rating	BBB/Stable/A-2

Ratings Detail (As Of May 3, 2019)*(cont.)	
Commercial Paper	
Local Currency	A-2
Senior Unsecured	BBB

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.