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Research Update:

Colombia Telecom 'BB+' Ratings Affirmed; Hybrid Capital Securities Rating Raised To 'BB-' From 'B+ On Criteria Change

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Overview

- Coltel's continued efforts to deploy its 4G network and Ultra Broad Band (UBB), the addition of Telebucaramanga and Metrotel's operations, and an improved capital structure should allow it to consolidate its position as the second-largest telecommunications company in Colombia in the next 12 months.
- We're affirming our 'BB+' corporate credit and debt ratings on Coltel. We're raising our rating on the company's hybrid capital securities to 'BB-' from 'B+'.
- The stable outlook reflects our expectation that Coltel's competitive position, along with higher cash flow generation due to a lower interest burden, will maintain debt to EBITDA and funds from operations (FFO) to debt at around 2.3x and 33%, respectively, for the next 12-18 months.

Rating Action

On May 25, 2018, S&P Global Ratings affirmed its corporate credit and senior unsecured note ratings on Colombia Telecomunicaciones S.A. E.S.P. (Coltel) at 'BB+'. We also raised our issue-level rating on the company's hybrid capital securities to 'BB-' from 'B+'.

Rationale

The rating action is based on Coltel's sustained operating performance, which will allow the company to consolidate its position as the second-largest player in Colombia's wireless and fixed line markets. Ratings reflect the company's improved fixed-line and broadband position after incorporating Metrotel and Telebucaramanga into its portfolio, which will help increase the company's market shares in those segments to 23.2% and 19.5%, respectively, from 18.2% and 15.5%. In our opinion, these factors should enable Coltel to increase its available cash, which we expect will help the company to continue deleveraging in the next 12-18 months.

We previously rated Coltel's hybrid capital securities at 'B+', reflecting a one-notch differential for contractual subordination and an additional one-notch deduction for payment flexibility to reflect the optional nature of

the deferral interest. According to our updated "Reflecting Subordination Risk In Corporate Issue Ratings" criteria published on Sept. 21, 2017, we now only deduct one notch for subordination in non-ranked jurisdictions, such as Colombia. However, we continue to incorporate a one-notch deduction due to optional interest deferral. Consequently, we now rate Coltels hybrid notes at 'BB-'.

Coltel continues to be a leader in the postpaid segment with a 26% postpaid ratio (postpaid subscribers as percentage of total), which is the highest among its Colombian peers. The company also benefits from its customer retention and satisfaction metrics, and improving profitability. However, we believe Coltel's limited 4G LTE coverage, which was 28% as of the end of 2017, in addition to its geographical concentration in Colombia, offset business strengths. In our opinion, the competition in Colombia's telecom industry will remain relatively unchanged over the near term, with Claro Colombia S.A. (not rated) dominating the market and Coltel as the second-largest player in the wireless and fixed line markets, while UNE EPM Telecomunicaciones S.A. (not rated) remains the second-largest broadband and TV player, despite the entrance of smaller players such as Avantel S.A.S. (not rated). Although we expect Coltel to modestly increase its market share across its multiple segments over the next few years, fierce competition will prevent major increases without an acquisition-based growth, in our opinion. Therefore, we don't discard a potential acquisition over the medium term.

Coltel has bolstered its capital structure because of last year's COP6.45 trillion (\$2.1 billion) capitalization, 67.5% of which were cash proceeds, which reduced the company's debt in half. We forecast that overall increased wireless penetration in Colombia, the company's operating efficiencies, and the incorporation of Metrotel and Telebucaramanga will help increase Coltel's EBITDA about 6% in the next 12 months. We expect these factors to result in a debt-to-EBITDA ratio at about 2.3x in 2018, and trending towards 2.0x in the following two years. Also, given the likely slowing of Coltel's capital expenditures (capex) in the next 12 months, we expect the company to fund it, along with working capital and license payments, through its own cash flows.

We continue to assess Coltel's group status in the Telefonica S.A. group as moderately strategic because we believe that the company's operations are reasonably successful and Telefonica is unlikely to dispose of its interest in Coltel in the near term. In addition, the group's capital injection into Coltel in 2017 supports this assessment.

In January 2018, the Colombian Government accelerated its plan to sell its 32.5% stake in Coltel. We understand that the transaction will follow a two-stage process as laid out in Colombian Law 266, which applies to the sale of state-owned shares. The first phase will target local pension funds, the company's employees, and other entities, which we expect to last until late July. The second phase includes a fully marketed equity offering that would target both local and international investors. This phase would take place between July and early August, when the company expects to reach an allocation or pricing settlement. Nevertheless, we don't discard the possibility of the

delay in the second phase until 2019, due to the upcoming presidential elections.

In our opinion, the government's intention of disposing of its stake in Coltél supports our view of the low likelihood of extraordinary government support, given the company's limited link--and importance--to the government.

Our base-case scenario incorporates the following assumptions:

- Colombia's GDP to expand at 2.5% in 2018 and 2.6% in 2019, and moderate inflation rates at 3.7% in 2018 and 3.5% in 2019. In our opinion, low inflation and GDP growth will continue to expand wireless and broadband operations in Colombia, which should raise Coltél's average revenue per user (ARPU) across its multiple segments and its revenue.
- Exchange rate of about COP3,000 per \$1 in 2018 and COP3,050 per \$1 in 2019. We believe that foreign exchange fluctuations are mitigated by Coltél's foreign-currency hedging strategies in the short term.
- Wireless expansion in Colombia to increase by 1.5%-2.0% on annual basis, reaching a penetration rate of about 126.5% by the end of 2018 and 128% by the end of 2019. We expect Coltél to capture some growth resulting from these dynamics and to improve its overall postpaid and prepaid customer base by slightly above 3% each year.
- Higher ARPUS, and broadband and pay-TV expansion will more than compensate for the decline in Coltél's fixed-line segment over the medium term.
- A mid-single digit revenue growth for 2018 and 2019.
- The customer migration into Full Stack--Coltél's customer management platform that includes a digital billing process and greater focus through automatic response solutions--will improve profitability by reducing call-center workforce and in-site billing, among other measures.
- Capex of about 20% of revenue in 2018 including license purchases, decreasing to 15% for the following years, and will be focused for the continued LTE and optic fiber deployment.
- Hybrid-related dividends of about COP130 billion on annual basis. Although excluded from our base case, this could increase if the company were to distribute dividends to its shareholders.

These assumptions result in the following credit measures for 2018 and 2019, respectively:

- EBITDA margins of 31.3% and 32.9%;
- Debt to EBITDA of 2.3x and 2.0x;
- FFO to debt of 33.9% and 42.0%; and
- Free operating cash flow (FOCF) to debt of 10.4% and 10.8%.

Liquidity

We assess Coltel's liquidity as adequate because we expect its sources over uses of cash above 1.2x and that sources will be greater than its uses even if EBITDA were to decline 15% from our base-case scenario in the next 12 months. Our liquidity assessment also incorporates Coltel's sound relationship with banks and a generally satisfactory standing in the international debt markets. Moreover, we believe the company will be in compliance of its 3.75x covenant under its senior notes for the next 12 months. We forecast covenant headroom of 45% for the same period.

Principal liquidity sources:

- Cash and liquid investments of COP72.5 billion as of March 31, 2018; and
- Projected cash FFO of about COP1.4 trillion.

Principal liquidity uses:

- Debt maturities of about COP434.9 billion in the next 12 months;
- Working capital outflows of about COP97 billion for the next 12 months;
- Maintenance capex of about COP290 billion; and
- Hybrid dividend payments around COP130 billion.

Outlook

The stable outlook reflects our expectation that Coltel will maintain its position as the second-largest wireless player in Colombia thanks to the planned LTE deployment and the incorporation of Telebucaramanga and Metrotel's operations, which will increase the company's share in the fixed-line and broadband markets. This, along with higher cash flows due to lower debt burden, should enable the company to post debt to EBITDA and FFO to debt metrics around 2.3x and 33% in the next 12-18 months, in our opinion.

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 ratios 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 the company's stronger competitive position.

Ratings Score Snapshot

Corporate 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

Group credit profile: bbb

Entity status within group: Moderately strategic (+1 notch from SACP)

Related government rating: BBB-

Issue Ratings--Subordination Risk Analysis

Capital structure

Coltel's total adjusted debt consists of COP4.2 trillion, out of which COP3.97 trillion correspond to reported debt, and COP266 billion represent the net of 50% of the company's hybrid securities, which we add to adjusted debt, and the deduction of about COP373 billion of cash and exchange-rate derivatives.

Out of the COP3.97 trillion of reported debt, COP2.2 (\$750 million) correspond to the company's senior unsecured notes due 2022, COP1.3 trillion to long-term local currency debt, and the remainder represents short-term credits in foreign and domestic currencies and other financial obligations.

Analytical conclusions

We rate Coltel's \$750 million senior unsecured notes due 2022 at the corporate credit rating level because the company doesn't have any secured debt, while debt at subsidiaries is moderate. Thus, we don't believe these factors imply material disadvantage to note holders. We now rate Coltel's hybrid capital securities at 'BB-'. We subtract one notch for subordination as Colombia is a non-ranked jurisdiction and we deduct an additional one-notch deduction due to optional interest deferral.

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

Ratings List

Ratings Affirmed

*Research Update: Colombia Telecom 'BB+' Ratings Affirmed; Hybrid Capital Securities Rating Raised To 'BB-'
From 'B+ On Criteria Change*

Colombia Telecomunicaciones S.A. E.S.P
Corporate Credit Rating BB+/Stable/--
Senior Unsecured BB+

Upgraded

	To	From
Colombia Telecomunicaciones S.A. E.S.P		
Subordinated	BB-	B+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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