2018-08-01 | Rating Action Commentary

Fitch Upgrades ColTel to 'BB+'; Outlook Stable

Fitch Ratings-Chicago-01 August 2018: Fitch Ratings has upgraded Colombia Telecomunicaciones S.A. ESP's (ColTel) Long-term Foreign and Local-Currency Issuer Default Ratings (IDRs) to 'BB+' from 'BB'. Fitch has also upgraded CoTel's senior unsecured 2022 bond rating to 'BB+' from 'BB' and its hybrid bond to 'BB-' from 'B+'. The Rating Outlook is Stable. A full list of rating actions follows at the end of this release.

The upgrade reflects capitalization by ColTel's shareholders on its former payment liability to Patrimonio Autonomo Receptor de Activos of Empresa Nacional de Telecomunicaciones (PARAPAT) and the effect on ColTel's balance sheet and cash flow generation going forward. Telefonica S.A.'s (TEF) 2017 sizable cash injection and the government's assumption of its portion of the liability strengthened ColTel's balance sheet resulting in a material debt reduction. This capitalization also freed approximately COP500 billion per year previously destined to service PARAPAT that will now contribute to the company's CFFO expected performance and deleveraging strategy.

The consolidation of leading telecom fixed operations in Bucaramanga and Barranquilla since 4Q17, following the termination of the PARAPAT operation agreement will contribute to improved EBITDA performance during the projection period. Fitch believes that towers and real estate properties that came from PARAPAT can be monetized and proceeds can be used to reduce indebtedness. The Stable Outlook reflects Fitch's expectation that ColTel's financial strategy will focus on reducing total debt in 2018 and 2019, which will improve the company's adjusted net leverage metric of 2.2x by 2020.

KEY RATING DRIVERS

Strong Market Position

ColTel is one of the leading providers of mobile data services in Colombia, with a national subscriber market share of 28.5% as of March 2018, behind Claro (53.1%), the biggest player by market share. For this same period, ColTel is also the third largest BBI service provider, with a 19.2% of subscriber market share and the fourth pay-TV provider with a market share of 10%. The company is expected to maintain its strong mobile footprint and to increase modestly its fixed business subscriber base, mainly in broadband and pay-tv, as it deploys its capex strategy aimed at increasing its network coverage and penetration.

Capitalization Strengthens ColTel's Credit Profile

The 100% pay down of the PARAPAT COP 4.8 trillion liability in September 2017 achieved a material debt reduction that strengthened its capital structure by significantly reducing its adjusted net leverage metric to 3x as of March 2018, below the average 5.3x leverage metric posted in 2014-2016. The capitalization also freed approximately COP 500 billion per year previously destined to pay associated interest payments that can now be used for investments or debt reduction. It also led to the consolidation of TeleBucaramanga and Metrotel, which will boost EBITDA by 5% per year. Furthermore; the acquisition of towers and real estate properties though this process is positive, as these assets can be monetized to accelerate deleveraging.

Operating Cash Flow to Improve

Fitch expects ColTel's EBITDA to increase to an average of COP1.8 trillion per year over the 2018-2020 period, up from COP1.5 trillion in 2017. EBITDA margin is expected to improve to 33.6% in 2020 from 31.5% in 2017 as a result of the expansion of its service portfolio and stronger ARPU performance, the consolidation of Metrotel and Telebucaramanga and the incorporation of cost efficiencies that should improve the cost as percentage of revenues ratio by 300 basis points by 2020. ColTel intends to use part of the increased operational cash flow expansion to fund capex in order to expand its LTE and FTTH networks in support of improved ARPU performance. For the next few years, Fitch expects ColTel to increase its fixed business revenue to an average of approximately COP2.1 trillion per year from COP1.8 trillion in 2017. This will contribute to close to 38% of total consolidated revenues, while the mobile operation will account for approximately 62% of total revenues as wireless/LTE portfolio continues to grow.

FCF Projection Outperforms Previous Base Case
Coltel's annual FCF generation is expected to average approximately COP430 billion for the next couple of years, which is above Fitch's previous projection of COP106 billion per year. The expected FCF improvement is driven by the projected EBITDA growth and lower capex intensity (capex/revenues) of 16% during 2018-2020, less than previous capex intensity forecast of 20%. The lower projected capex cash outlay is explained by capex optimization initiatives that focus on higher ARPU services such as mobile data and FTTH and capex savings to connect new subscribers to its FTTH network in 2018-2020.

Deleveraging Trend Expected
Fitch expects Coltel to pay debt by COP338 billion in 2018 and COP 846 billion in 2019 and to substitute part of that debt with longer tenor instruments in order to increase average life from approximately 3.7 years as of March 2018 to between seven and 10 years. This financial strategy would result in net debt reductions of approximately COP 544 billion in 2018 and COP 435 billion in 2019. This in conjunction with the expected EBITDA improvement would reduce the adjusted net leverage metric from 3x in March 2018 to 2.2x by 2020, outperforming Fitch's 2017 forecast of 2.5x as of that date.

DERIVATION SUMMARY

ColTel's 'BB+' rating reflects its relatively more concentrated service portfolio given its weaker fixed business operation compared to its peers UNE EPM Telecomunicaciones S.A. (BBB/Stable) and Telefonica Moviles Chile S.A. (BBB+/Stable), companies that boast a more balanced subscriber base per business segment with stronger fixed internet and TV operations. On the other hand, ColTel's credit profile is stronger than Axtel (BB-) and VTR Finance (BB-) given their less diversified operations and weaker financial profiles.

Fitch expects ColTel's capital structure to improve by reaching an adjusted net leverage ratio of 2.2x by 2020, closer to the expected leverage performance for UNE EPM but above Telefonica Moviles Chile's leverage metric (below 2x) given its conservative capital structure. ColTel's capital structure is considered stronger than Axtel and VTR, given their projected leverage metric is close to 4x.

KEY ASSUMPTIONS

--Core Revenues grow at an average of 5.5% year in 2018-2020, driven by 4.7% mobile average growth and 6.7% fixed revenue growth;
--EBITDA averages COP1.8 trillion during the projection period;
--Moderate EBITDA growth and debt prepayments in 2018 and 2019 allow for the adjusted net leverage metric to improve to 2.2x in 2020;
--Capex, including licenses, of COP2.6 trillion in 2018-2019 as indicated by the company;
--No dividend payments during the rating horizon.

RATING SENSITIVITIES

Developments that May, Individually or Collectively, Lead to Positive Rating Action
--The strengthening of the fixed operation in support of EBITDA generation leads to a market share improvement in its fixed business;
--The company registers an adjusted net leverage metric below 2x on a sustained basis.

Developments that May, Individually or Collectively, Lead to Negative Rating Action
--Sustained profitability deterioration due to competitive pressures and slow growth in its non-traditional business segments;
--Negative FCF generation;
--Adjusted net leverage above 3x on a sustained basis.

LIQUIDITY

ColTel's liquidity has improved after the capitalization process that paid the PARAPAT liability and cured the piercing of the 2022 bond leverage covenant (below 3.75x) affording the company increased financial flexibility by allowing it to contract additional debt if needed. ColTel posted a CFFO of COP878 billion as of LTM March 2018 and cash balances including short-term investments of COP73 billion, resources more than sufficient to meet short-term debt obligations of COP435 billion as 1Q18. ColTel reported COP555 billion in available lines of credit (COP374 billion with local banks and COP181 billion with international banks) that further bolster its liquidity position.

The capitalization by the shareholders in September 2017 substantially improved the capital structure and liquidity of ColTel by reducing the total amount of adjusted debt and associated PARAPAT's interest payable. The leverage metric stood at 3.1x as of March 2018, well below adjusted leverage metrics above 5x posted before the capitalization was held. Going forward ColTel's financial strategy will seek to reduce its adjusted net leverage metric close to 2x by prepaying debt in 2018 and 2019 and to improve the average life of its financial debt to over seven years from the current three years, further strengthening its liquidity position.

FULL LIST OF RATING ACTIONS

Fitch has upgraded ColTel's rating as follows:

--Long-term, foreign-currency IDR to 'BB+' from 'BB'; Outlook Stable;
--Long-term, local-currency IDR to 'BB+' from 'BB'; Outlook Stable;
--2022 senior notes to 'BB+' from 'BB';
--Subordinated notes to 'BB-' from 'B+'.

Contact:

Primary Analyst
Sul Ahmad, CFA
Associate Director
+1-312-368-3348
Fitch Ratings, Inc.
70 West Madison St.
Chicago, Il 60602

Secondary Analyst
Julio Ugueto
Associate Director
+571-307-5180 ext. 1038

Committee Chairperson
Joseph Bormann, CFA

Managing Director
+1-312-368-3349

Media Relations: Elizabeth Fogerty, New York, Tel: +1 212 908 0526, Email: elizabeth.fogerty@fitchratings.com

For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable Criteria

Corporate Rating Criteria (pub. 23 Mar 2018)
National Scale Ratings Criteria (pub. 18 Jul 2018)
Parent and Subsidiary Rating Linkage (pub. 16 Jul 2018)

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