Fitch Affirms Colombia Telecomunicaciones at BBB-/Stable

Fitch Ratings has affirmed all of Colombia Telecomunicaciones SA ESP's (ColTel) ratings, including the Long-Term (LT) Foreign Currency (FC) and Local Currency (LC) Issuer Default Ratings (IDR) of BBB-, and the company's unsecured debt at BBB-. The Rating Outlook is Stable.

The ratings reflect the company's stable business position, and Fitch's expectation that the company will maintain leverage commensurate with the rating level in the medium term. Fitch expects that the company's investments will support the company's stable business position by diversifying revenue streams and improving network coverage in a competitive Colombian market.

KEY RATING DRIVERS

Trend Outweighs Temporary Rise in Leverage: Fitch expects that ColTel's leverage metrics will rise above Fitch's downgrade sensitivities in the near term before returning to more conservative levels. The refinancing of the hybrid note, which qualified for 50% equity credit, and the impact of the economic lockdown on operating margins will cause Debt / adjusted EBITDA and Net Debt / adjusted EBITDA to both rise above Fitch's sensitivities of 3.0x and 2.75x, respectively. The stability of the company's business position and Fitch's expectation of strong operating cash flow generation both support Fitch's view that the company will deleverage to around 2.25-2.5x over the rating horizon, in line with the company's trends since the 2017 recapitalization.

Stable Operations Provide Flexibility: ColTel has demonstrated relatively stable operating performance over the last 4 years, as revenues have consistently grown in the low to mid-single digit range. Heading into the coronavirus downturn, the company secured an important B2B contract which should contribute consistent cash flows over the rating horizon. Fitch expects that the company will be able to maintain adjusted EBITDA margins in the 30% range over the rating horizon, sufficient to cover investments, reduced interest expense, and consistent cash taxes. The company has some flexibility to reduce capex in 2020 following a heavy investment period. As part of wider Telefonica initiatives throughout the region, Fitch expects ColTel to divest non-core assets, which should further improve financial flexibility.

Coronavirus Impact on Telecoms: Fitch does not expect the same level of disruption to telecom as other sectors from the coronavirus. Increased screen and voice time, across both fixed and mobile platforms, will likely be offset by declining disposable income, pressuring revenues and EBITDA generation. A prolonged recession, and/or significant government intervention into telecom operators' price-setting, would be negative. The Colombian mobile market is heavily prepaid with ~ 80% of subscribers, which are more price-sensitive and lower value than post-paid. Positively, low broadband penetration presents a growth opportunity; however, the company is in a weaker competitive position in Bogota and Medellin.

Steady Market Position: ColTel is the second largest telecom operator in Colombia, behind America Movil S.A.B. de C.V.'s (A-/Stable) Claro, which is roughly 2x the size. The company's competitive position is supported by subscriber shares of 25% in mobile, 17% in broadband, and 9% in Pay TV share. These market shares have been generally stable over time; and Fitch ColTel and UNE EPM Telecomunicaciones (Tigo Une, BBB/Negative) to vie for the #2 spot behind Claro. In 2019, Novator Partners, the owners of Chile's WOM S.A. (WOM, BB-/Stable) participated in the December spectrum auction, although the strategy for a Colombian entry is unknown at this point.

Diverse Revenue Streams: The company has a diversified service portfolio with a national footprint and improving 4G and fiber broadband networks. Mobile accounts for approximately 60% of revenues in 2019, in line with the regional median. The company's fixed line presence, where it is the #3 behind Tigo Une and geographic distribution improved with the consolidation of operations in Bucarmaranga and Baranquilla following the PARAPAT resolution. Fitch expects that broadband and Pay TV operations will continue to exhibit strong growth as the company invests in its fiber network to provide broadband and IPTV services.

Parent and Government Linkages: A linkage exists between the company and its 67.5% owner, Telefonica SA (BBB/Stable); however, Fitch's ratings of ColTel are on a stand-alone basis. As the ratings do not assume any further support from Telefonica, ColTel's ratings have not been impacted by the proposed spin-off of Telefonica's Latin American (ex-Brazil) operations. The exact nature of the spin-off is unclear at this point, and won't impact the ratings unless there is a greater consolidation of financial and operational functions between the regional entities. The Colombian government (BBB-/negative), which owns 32.5%, doesn't exert control the management of ColTel; therefore, the ratings are also not directly linked.

DERIVATION SUMMARY

ColTel's overall business and financial profile is similar to that of direct competitor UNE EPM Telecommunications (Tigo Une, BBB/Negative), with similar revenue shares of the overall Colombian, although UNE EPM has a longer history of maintaining lower leverage. Tigo Une is also relatively stronger in the fixed broadband and Pay-TV business, which could imply more subscription like cash flows, as the Colombian mobile market is mostly prepaid (around 70-75%). Tigo Une's ratings are constrained by the BBB Country Ceiling of Colombia.

Sister company Telefonica del Peru (TdP, BBB/Stable), has a stronger business profile, owing to its leading market shares in both fixed (~70%) and mobile (~35%). Leverage at the two is broadly similar, following TdP's international bond placement in 2019. The Peruvian telecom space has been even more competitive than Colombia's, due to 2 new entrants since 2015.

Compared to Telefonica Moviles Chile (TMCH, BBB+/Stable), ColTel has weaker market shares and a less conservative financial structure. ENTEL (BBB-/Negative) has seen its leverage approximately double since entering the Peruvian market nearly 5 years ago. While the company benefits from its status as the largest Chilean mobile operator with leading post-paid market shares and ARPUs, the negative outlook on its ratings reflects consistently negative FCF and leverage that has been too high for investment grade over the last 3 years.

ColTel's greater scale, diversified revenue streams compare favorably to Colombian fixed-line provider Empresa de Telecomunicaciones de Bogotá (ETB, BB+/Stable). ETB maintains a BB+ rating on the strength of its conservative financial structure.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Total revenues growing from COP5.16b in 2019 to COP5.45b in 2022, with ~30% adjusted EBITDA margins, which exclude asset sales and IFRS16 add-back
- Mobile subscribers growing in the 1-3% range, with postpaid growing more quickly than prepaid, and ARPUs declining by 3% on average
- Fixed line subscribers flat as telephone attrition is mitigated by growing broadband and PayTV customers, resulting in ARPUs growing in the 3-5% range
- SENA revenues and EBITDA in line with company guidance
- Capex of around 14-15% of revenues in 2020 and 15-16% thereafter
- Some deterioration in working capital as customers lengthen out payment cycles
- Asset sales to continue

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Total debt/EBITDA falling below 2.0x or net debt/EBITDA falling below 1.75x on a sustained basis due to a strengthening of the competitive position and/or FCF being used to pay down debt, along with an improvement in the strength of the company's broadband and pay TV market position;

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Total debt/EBITDA rising above 3.0x or net debt/EBITDA rising above 2.75x on a sustained basis due to a weakening of the competitive position and/or debt-financed acquisitions.

LIQUIDITY

Adequate Liquidity: ColTel has adequate liquidity, backed by its strong operating cash flow generation and manageable amortization profile. As of March 31st, the company had cash of COP121 billion, against short term debt (ex-leases) of around 328, following a heavy 1st quarter of capex. The company actively hedges its USD750m bond exposure, which provides additional financial flexibility as USDCOP has gone from 3280 to 4070.

FULL LIST OF RATING ACTIONS

Colombia Telecomunicaciones S.A. E.S.P.

- LT FC and LC IDRs affirmed at BBB-/Stable
- Unsecured debt including 2022 USD notes affirmed at BBB-

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Date of Relevant Rating Committee: June 26th 2020

Summary of Financial Statement Adjustments –

- Fitch applies 50% equity credit to perpetual note, which was called in 1Q2020
-Interest on perpetual note was included in cash interest in cash flow from operations
-EBITDA adjusted for asset sales

-Leases adjusted consistent with new criteria.

Additional information is available on www.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.