S&P Global Ratings

RatingsDirect®

Research Update:

Colombia Telecomunicaciones S.A. E.S.P Outlook Revised To Negative Amid Expected Higher Leverage; 'BB+' Ratings Affirmed

March 30, 2020

PRIMARY CREDIT ANALYST

Humberto Patino

Mexico City

+ 52 55 5081 4485

humberto.patino@spglobal.com

SECONDARY CONTACT

Fabiola Ortiz

Mexico City

(52) 55-5081-4449

fabiola.ortiz@spglobal.com

Rating Action Overview

- Colombia-based telecommunication service provider, Colombia Telecomunicaciones S.A. E.S.P.'s (Coltel) S&P Global Ratings-adjusted leverage credit metrics will fall below our expectations for the next two years, due to hybrid debt refinancing given that 50% of total hybrid securities were accounted as equity. In addition, sluggish economic growth, as a result of COVID-19, could compromise the company's growth prospects.
- On March 30, 2020, S&P Global Ratings revised its outlook to negative from stable on Coltel. In addition, we affirmed the ratings at 'BB+'.
- At the same time, we withdrew our hybrid securities rating of 'BB-' after the company called the bond on March 30, 2020.
- The negative outlook on Coltel reflects our expectation of weaker credit metrics throughout 2020 that could raise its debt to EBITDA consistently above 3.0x due to a negative impact from the refinancing of its hybrid securities and from raising additional short-term loans, amid adverse economic and business conditions. Additionally, if we view a lower likelihood of support from the parent, Telefonica S.A., we could also take a negative action on Coltel.

Rating Action Rationale

Coltel's debt refinancing will increase its debt and raise exposure to foreign exchange rates. As of March 30, 2020, the company completed the refinancing of its $500 million "intermediate equity" content hybrid bond through five-year bullet tenor loans with a local bank and is expected to take additional short-term bank loans of Colombian peso (COP) 70 billion for working capital requirements. As a result, we expect these transactions to raise the company's debt, which would weaken Coltel's credit metrics, with debt to EBITDA above 3.0x. These metrics deviate substantially from our previous expectations.

The company exchanged its hybrid securities for local bank loans for an equivalent of COP1.7

trillion (compared with around COP1.27 trillion as of Dec. 31, 2019), which will represent around COP400 billion in additional debt due to the Colombian peso's falling value. This accounting reclassification considers a hedged exchange rate of approximately COP3,400 per U.S. dollar. Even though the purpose of this transaction is to reduce hybrid instrument's higher debt costs, as the company was benefiting from lower S&P Global Ratings-adjusted leverage metrics, given that 50% of total hybrid securities were accounted as equity. At this point, we're adding an additional COP850 billion to our adjusted debt calculations.

Finally, we expect the company to take additional short-term loans totaling about COP70 billion for operational growth plans.

The economic downturn, due to the COVID-19 crisis, would delay Coltel's growth prospects. The economic hit would depress the company's business to business (B2B) segment, mainly because most of its corporate clients have shut down their in-office operations. We believe Coltel would mitigate revenue losses in this segment by ramping its massive segment services such as broadband, paid-TV, and mobile connectivity. However, given uncertainty over the magnitude and duration of these conditions, the company's growth plans for 2020, and to some extent, for 2021 could be delayed. This would translate into lower-than-expected EBITDA and higher working capital requirements from lower receivables for the next two years, further weighing on Coltel's leverage metrics.

Telefonica's spinoff of Latin American subsidiaries (excluding those in Brazil) could point to lower commitment of extraordinary support for Coltel. We believe that in the event that Coltel's long-term relevance to its parent diminishes, this could lead to possible divestures in the region. In addition, we could perceive lower likelihood of extraordinary support, if Telefonica transfers its HISPAM subsidiaries to a special purpose vehicle, in which it won't own the majority stake. We will continue monitoring upcoming announcements regarding the future strategic plans of Telefonica's operating spin-offs and how they will reflect on our assessment of Coltel as a moderately strategic subsidiary.

Outlook

The negative outlook reflects our view of a possible two-notch downgrade in the next 12 months if the company falls below our leverage metric expectations with debt to EBITDA above 3.0x amid the refinancing of its hybrid securities, while we believe Coltel is no longer a moderately strategic subsidiary.

Downside scenario

We could lower the ratings in the next 12 months or so if Coltel's credit metrics erode due to adverse economic and business conditions, such as intense competition, foreign exchange volatility, and the impact of COVID-19. In such a scenario, debt to EBITDA would rise above 3.0x as the company refinances its "intermediate equity" content hybrid securities through multiple bank loans. We could also lower the ratings if we perceive less commitment from Telefonica to provide extraordinary support or if we believe that it will likely sell Coltel in the short term.

Upside scenario

We could revise the outlook to stable in the next 12-18 months if the company generates higher

EBITDA to mitigate its exposure to higher debt obligations, resulting in debt to EBITDA below 3.0x, funds from operations (FFO) to debt of 20%-30%, and free operating cash flow (FOCF) to debt close to 5%. This could occur if Coltel maintains low churn rates through its "#RECONECTA" strategy and maintains its market share in mobile and fixed services.

Company Description

Coltel is an integrated telecommunications provider that operates under the trademark Movistar. It has been part of the Telefonica group since 2006. In 2012, Coltel merged with Telefonica Moviles Colombia S.A. As of this report's date, Telefonica (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 services (such as data centers and IT services).

Our Base-Case Scenario

- Colombia's GDP growth of 2.4% for 2020 and 3.3% for 2021 and CPI inflation of 3.9% and 3.0%, respectively. These macroeconomic conditions will support the telecom industry in the next two years, because these are the main drivers for customers to measure spending increases for the year.
- Average exchange rate of COP3,750 per $1 for both 2020 and 2021. For 2020, the company holds a non-delivery forward instrument to cover the unsecured senior bond's outstanding amount for an average exchange rate of COP3,400 per $1.
- Revenue decline of 0.9% for 2020. In addition, we expect a constant drop in average revenue per user (ARPU) to retain market position and reduce churn rates. Total revenue to rise around 1.5% for 2021.
- Coltel to maintain cost-reduction measures to mitigate pressure on its EBITDA margins, such as digitalization initiatives, online customer centers, and mobile apps. We expect these factors to offset the lower ARPU and demand.
- Annual capital expenditure (capex) of about COP1.2 trillion for 2020 and COP891 billion for 2021 for licensing payments, the SENA project, 4G deployment, FTTH (fiber-to-home), big data, among other new services.
- Approximately COP550 billion in cash inflows from non-core asset sales in 2020.
- No dividends in the next two years, except for the already executed payment in the first quarter of 2020 related to the hybrid securities.
- After completing its refinancing, we believe Coltel's adjusted total debt would increase to COP5.8 trillion in 2020 and drop to COP5.1 trillion in 2021.

Based on these assumptions, we arrive at the following credit measures for the next two years:

- Adjusted EBITDA margins of 28%-30%.
- Debt to EBITDA above 3.0x.
- FFO to debt of 20%-30%.
- FOCF to debt below 5%.

Liquidity

We consider Coltel's liquidity as adequate because estimated cash sources will cover estimated uses by 1.2x for the next 12 months. We believe that even if EBITDA were to decline as much as 15%, liquidity would be sufficient to meet financial obligations. Coltel has stable banking relationships and has proven a generally satisfactory standing in credit markets.

Principal liquidity sources:

- Cash on hand and short-term investments of around COP411 billion as of Dec. 31, 2019; and
- Expected FFO above COP1.3 trillion for the next 12 months.

Principal liquidity uses:

- Debt maturities of about COP210 billion as of Dec. 31, 2019;
- Working capital needs, including seasonal requirements, for about COP335 billion for the next 12 months;
- Maintenance capex of about COP816 billion for the next 12 months; and
- Approximately COP70 billion for the next 12 months in dividend payments from hybrid securities.

Covenants

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. Based on our assumptions, our base-case scenario assumes that the company won't breach its leverage threshold in the next 12 months. Moreover, the company aims to complete its refinancing strategy during 2020.

Issue Ratings - Subordination Risk Analysis

Capital structure

Coltel's capital structure consists of $750 million senior unsecured notes, $500 million in hybrid securities, and debt banks.

Analytical conclusions

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

Ratings Score Snapshot

Issuer Credit Rating: BB+/Negative/--

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)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- 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 | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Not Rated Action

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

Ratings Affirmed

Colombia Telecomunicaciones S.A. E.S.P		
Senior Unsecured	BB+	

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Colombia Telecomunicaciones S.A. E.S.P		
Issuer Credit Rating	BB+/Negative/--	BB+/Stable/--

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.