S&P Global
Ratings

RatingsDirect®

Research Update:

Colombian Telecom Operator Coltel Outlook Revised To Stable From Negative On Faster Deleveraging; 'BB' Ratings Affirmed

March 29, 2022

PRIMARY CREDIT ANALYST

Humberto Patino
Mexico City
+ 52 (55) 50814485
humberto.patino
@spglobal.com

SECONDARY CONTACT

Fabiola Ortiz
Mexico City
+ 52 55 5081 4449
fabiola.ortiz
@spglobal.com

Rating Action Overview

- Colombian telecom service provider Colombia Telecomunicaciones S.A. E.S.P. (Coltel) reduced its debt by about COP756 billion, allowing debt to EBITDA drop below 3.0x. We revised upward its stand-alone credit profile (SACP) to 'bb' from 'bb-'.
- On March 29, 2022, S&P Global Ratings revised its outlook on Coltel to stable from negative and affirmed its 'BB' issuer credit and issue-level ratings on it.
- The stable outlook reflects our view that, for the next 12-18 months, the company will focus on expanding its fiber optic services through which it will increase its customer base and offset the impact of competitive pricing in the region. This will allow Coltel to generate consistent EBITDA and depend less on debt funding, maintaining debt to EBITDA below 3.0x.

Rating Action Rationale

Fiber assets divestment accelerated Coltel's deleveraging. Coltel sold its fiber optic assets to Onnet Fibra Colombia S.A.S. (Onnet; a subsidiary of Kohlberg Kravis Roberts [KKR]) and, at the same time, the company acquired a 40% stake in Alamo HoldCo S.L. (Alamo; Onnet's parent company). On Jan. 11, 2022, after obtaining the regulatory authorizations, the transaction was completed. The company received approximately COP757 billion (or $187.3 million) in net proceeds (after acquiring 40% stake on Alamo). We now expect the company to contractually receive wholesale connectivity services and fiber network deployments from Onnet. Coltel used these funds for debt repayment prior to maturities, resulting in a faster-than-expected deleveraging with debt to EBITDA falling below 3.0x as of Feb. 28, 2022. As a result, we revised our assessment of the company's financial risk profile to significant from aggressive, prompting the upward revision of stand-alone credit profile (SACP) to 'bb' from 'bb-'.

We believe that the telecom industry in countries, such as the U.S., Mexico, and other advanced economies countries in Latin America, has been moving towards the separation between services and infrastructure segments. Therefore, most of the carriers in the industry have divested fiber and tower assets to peers that are prioritizing investing in infrastructure growth. This is in order to provide connectivity services to the same carriers and reduce the investment burden for constant network upgrades.

The company refinanced its debt to improve its credit composition and debt in foreign currency. During 2021, Coltel repaid its $250 million (COP923 billion) syndicated loan ahead of maturity through about $119 million with cash on hand and the remaining $131 million in new debt. Moreover, the company partly prepaid its U.S. bank loan of $83 million (COP331.8 billion) with cash flows ($58 million or COP233.8 billion) and the remaining $25 million (COP98.0 billion) in new debt. Debt repayment strategy is part of the company's plan to reduce maturity pressures, as well as to lessen its exposure to debt in foreign currency. Additionally, the new debt has competitive interest rates that will cause financing costs to fall through a sustainability-linked loan and other local bank loans. As of Dec. 31, 2021, Coltel was in compliance with its sustainability KPI goals to maintain this interest rate.

We revised our view of Coltel's subsidiary status to nonstrategic from moderately strategic. We now view Coltel as a nonstrategic subsidiary of Telefonica S.A. (TEF; BBB-/Stable/A-3), removing the one-notch uplift of the issuer credit rating from SACP. This is based on our view that TEF's Latin American subsidiary will have to act autonomously. As a result, we no longer believe Coltel will receive extraordinary support directly from TEF. TEF has been pushing Hispam (group of Latam subsidiaries Chile, Colombia, Peru, Mexico, Ecuador and others) to reduce risk exposure to foreign-exchange rate volatility and to reorganize its capital structure to align with Latin America's economic conditions. As of Dec. 31, 2021, Coltel represents about 3% of the TEF's total EBITDA, lower than those of other subsidiaries of the group.

Coltel's three-year plan focuses on business growth through efficient allocation of resources. The plan is to expand Coltel's mobile and fixed services to raise the company's market share by increasing its number of customers through lower prices amid fierce competition in the region. The company will continue to expand its fiber-optic network (now through Alamo) to gain competitive advantage in terms of speed and quality of service. As well as increase approximately 3 million homes passed in the next three years, shut down the 2G network in 2024, and maintain spectrum renewals that will expire in 2023. Coltel plans to accomplish these tasks through lower capex after the divestment of fiber assets, efficient cost structure, and extended debt maturity schedule.

Outlook

The stable outlook reflects our view that Coltel will continue focusing on increasing its market share by offering services through increased fiber optic coverage across the region, allowing the company to fund growth through its operating cash flows. Moreover, because we don't expect additional debt for the next 12-18 months, we expect debt to EBITDA to remain below 3.0x.

Downside scenario

We could lower the ratings on Coltel in the next 12-18 months for the following reasons:

- Coltel is unable to compensate for lower prices through higher subscriber base, given intense competition, lost market share, and lower-than-expected EBITDA, all of which would cause debt to EBITDA to rise above 3.0x.

- The company fails to reduce capex or requires higher-than-expected operating cash flows for license renewals, incurring additional debt that will also weaken leverage metrics and/or erode liquidity position.

Upside scenario

We could raise our ratings on Coltel if debt to EBITDA drops below 2.0x in the next 12-18 months, thanks to a faster-than-expected fiber optic deployment across the region, which allows the company to expand its customer base and enhance its pricing power against those of industry peers.

Company Description

Coltel is an integrated telecom 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 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

S&P Global Ratings' economic assumptions include:

- Colombia's GDP growth of 3.5% in 2022 and 3.0% in 2023, and CPI of 4.1% and 3.4%, respectively.
- These economic conditions suggest favorable prospects for Coltel's revenue, because we expect the economic recovery will start to compensate for the delays in fiber optic deployments and increased coverage. Also, given that the company is focused on postpaid services and FTTH, we expect these economic conditions to cause Coltel's equipment sales to recover.
- Coltel's operating currency is the Colombian peso (COP). As of Dec. 31, 2021, about 57% of total debt is denominated in U.S. dollars and the remaining 43% in domestic currency. We believe the company faces low volatility on its dollar-denominated debt, because Coltel manages the risks through the use of derivative financial instruments on exchange rates and interest rates, as well as taking into account the net positions of the balance sheet in order to take advantage of natural hedges to avoid incurring excess bid-offer spread costs in hedging operations.

Our operating and financial assumptions on Coltel include:

- Revenue growth of 7.1% to COP6.3 trillion in 2022 and 4.6% to COP6.6 trillion in 2023.
- About 52% of total revenue to come from mobile services for the next two years. This is mainly due to the likely transition of subscribers from prepaid to postpaid services, as well as competitive prices to expand customer base in Coltel's operating segments.
- Forty six percent of total revenues to continue coming from fixed services for the next two years. We assume that this segment will continue to grow in accordance with the fiber network deployment plans, allowing Coltel to gain competitive advantage over its regional peers in

terms of speed and quality of service. Moreover, paid TV services to continue gaining prominence through the integration of more streaming applications and through commercial strategies to capture a higher level of subscribers.

- Operating costs to grow slightly above those in 2021, in line with interconnection expenses given increased traffic and fiber deployment, as well as efforts to add customers and offset competitive pricing. Inflation in Colombia will also influence electricity prices and the company's payroll in 2022.
- Adjusted annual EBITDA of about COP1.7 trillion for the next two years.
- Capital expenditures (capex) to remain in line with the 4G network and fiber deployment: about COP630 billion in 2022 and COP660 billion in 2023. Moreover, we expect capex to increase according to license renewals in the next two years.
- The company to prepay approximately COP857 billion through the proceeds from the sale of fiber assets. No incremental debt as the company plans to use its funds to cover investments. Therefore, adjusted debt to remain steady at COP4.6 trillion in the next two years.

These assumptions result in the following credit metric measures for 2022 and 2023, respectively:

- Average EBITDA margin of 26%;
- Debt to EBITDA slightly below 3.0x;
- Funds from operations (FFO) to debt of 26%-28%; and
- Free operating cash flow (FOCF) to debt below 5%.

Liquidity

We continue assess Coltel's liquidity as adequate, based on its efforts to raise cash inflows to reduce debt. As of February 2022, Coltel had received approximately COP756 billion in net proceeds from the sale of fiber optic assets to Onnet. This reduced the capex the company would otherwise have made for fiber deployment in future. Therefore, we continue to expect its cash sources to cover estimated uses by more than 1.2x for the next 12 months. If EBITDA were to decline by as much as 15%, liquidity would be sufficient to cover maintenance capex and financial obligations. In addition, we believe that Coltel's sound relationship with banks strengthened its capital structure and underscore the company's wide access to external financing.

Principal Liquidity Sources

- Cash and liquid investments of COP548.1 billion as of Dec. 31, 2021;
- Expected cash FFO of COP993.1 billion for the next 12 months; and
- Proceeds from fiber optic asset sales for COP756 billion as of February 2022.

Principal Liquidity Uses

- Scheduled financial obligations of about COP73 billion as of Dec. 31, 2021;
- Partial repayment of its debt through asset sales proceeds and cash in hand for about COP857 billion as of Feb. 28, 2022;
- Working capital requirements of about COP100 billion for the next 12 months; and
- Capex (excluding for license renewals) of COP630 billion for the next 12 months.

Covenants

As of Feb. 28, 2022, Coltel doesn't have any financial covenants on its debt.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of Dec. 31, 2021, the company reported COP4.5 trillion in total debt. About COP2 trillion come from its 4.95% senior unsecured notes due 2030, COP798 billion from its recent sustainability-linked credit, and about COP2 trillion in other bank loans.

Analytical conclusions

We don't believe there's significant subordination risk on the company's debt and our recommendation is to affirm our issue-level rating at 'BB', the same level of the recommended ICR.

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: Nonstrategic (no impact)

- Likelihood of government support: Low (no impact)

Colombia Telecomunicaciones S.A. E.S.P.: (E-2/S-2/G-2)

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, 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
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

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/Stable/--	BB/Negative/--

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.