FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Colombia Telecomunicaciones S.A. E.S.P. at 'BBB-'; Outlook Stable

Wed 22 Jun, 2022 - 16:34 ET

Fitch Ratings - Chicago - 22 Jun 2022: Fitch Ratings has affirmed all of Colombia Telecomunicaciones S.A. E.S.P.'s (ColTel) ratings, including the Long-Term Foreign Currency (FC) and Local Currency (LC) Issuer Default Ratings (IDR) at 'BBB-'/Stable and its unsecured instrument ratings including the USD500 million notes due 2030 at 'BBB-'.

The affirmation reflects Fitch's expectations that the company will maintain its position in both mobile and fixed services through network investments and co-investments. These dynamics should support relatively stable EBITDA generation and leverage. The ratings also reflect the company's status as the second largest telecom operator, with well-defined mobile, fixed and B2B offerings.

The level of competitive intensity in Colombia is high in both mobile and fixed segments. If price competition or overly aggressive commercial offers cause subscriber shares or cash flows to deteriorate, Fitch may take a negative rating action on ColTel.

KEY RATING DRIVERS

Growth Offsetting Profitability Pressure: ColTel demonstrated relatively stable operating performance over the last three years. Revenues and subscribers grew consistently in both fixed and mobile segments, which helped offset weakening profitability resulting from the continuous decline in mobile average revenue per user (ARPU) and overall higher direct costs and commercial expenses. Fitch forecasts EBITDA margins of close to 20% from 27% in 2019, to reflect additional operating expenses associated the use of third-party fiber optic networks as well as certain direct operating expenses (e.g., inventory), which are likely to remain high over the rating horizon.

Good Market Positions: ColTel is the second-largest mobile operator in Colombia, behind America Movil S.A.B. de C.V.'s (A-/Positive) Claro, which is roughly twice the size, and the third largest in broadband internet. The company's competitive position is supported by subscriber shares of 25% in mobile, 14% in broadband and 12% in Pay TV share. These market shares have stayed generally stable over time. Fitch expects ColTel and UNE EPM Telecomunicaciones (Tigo Une; BBB-/Stable) to vie for the number two spot behind Claro. In addition, the company has a solid B2B offering, which generates approximately 25%-30% of consolidated revenue.

Fiber Co-investments: The company closed the sale of its fiber-optic assets to neutral network operator Onnet Fibra Colombia S. A. S. for USD328 million of which ColTel received USD187 million in cash, a USD94 million long-term receivable while maintaining a 40% indirect equity stake in the assets. Investment firm KKR indirectly holds the remaining 60% stake. Onnet Fibra Colombia and ColTel have agreed on a fiber-optic network expansion plan that seeks to increase ColTel's fiber optic coverage from approximately 1.2 million homes at YE 2021 to a minimum of 4.3 million homes by the end of 2024. We expect ColTel to shift its existing customer base to fiber from copper over the next three to four years.

Debt Reduction to Pre-pandemic Levels: Fitch expects ColTel's net debt to close the year at COP3.3 trillion, which is in line with the amount of debt the company had at the end of 2019. This compares with COP4.3 trillion in 2020 as the company increased its leverage mainly to fund FTTH expansion and 4G capacity. We expect the company will have capex in the 11%-14% range, including spectrum payment renewals, over the rating horizon.

Intense Competition: The Colombian mobile market is expected to continue to show significant pricing pressures as WOM Colombia seeks to become a relevant player and incumbent operators increase or maintain promotions and in some cases lower prices while a portion of customers downgrade to lower priced plans. We expect competition for subscribers to remain intense. The country's mobile penetration which is approaching

150% compared with 135% in 2019 is also contributing to lower ARPUs. Competition is also growing in fixed broadband although we expect ColTel to be a challenger in this segment with fiber-optic expansion accelerating customer acquisitions leading to market share gains over the rating horizon.

Parent and Government Linkages: A linkage exists between the company and its 67.5% owner, Telefonica S.A. (BBB/Stable); however, the ratings of ColTel are on a standalone basis and do not assume support from Telefonica as legal, strategic and operational support incentives are low. There aren't debt guarantees or cross default clauses between the two and ColTel accounts for only about 3% of Telefonica's consolidated revenues. Operational incentives are relatively weak, as the subsidiaries tend to be independently managed and financed. The Colombian government has a 32.5% stake in the company but does not exert control over the management of ColTel; therefore, the ratings are also not directly linked.

DERIVATION SUMMARY

ColTel's overall business and financial profile is similar to direct competitor Tigo Une, with a similar revenue share of the overall Colombian market, although Tigo Une has a longer history of maintaining lower leverage. Tigo Une is also relatively stronger in the fixed broadband and PayTV business, which could imply more subscription-like cash flows, as the Colombian mobile market is mostly pre-paid. Tigo Une's ratings are constrained by Colombia's 'BBB-' Country Ceiling.

Telefonica del Peru, S.A.A. (TdP; BB+/Negative), has a strong market share in fixed, at approximately 60%, while Peru's relatively even four-operator mobile market is even more competitive than Colombia. ColTel carries lower leverage than TdP and has a superior cash flow profile as TdPs profitability has suffered even more than ColTel's in recent years.

Compared with Telefonica Moviles Chile S.A.(BBB+/Stable), ColTel has weaker market share and a less conservative financial structure. Empresa Nacional de Telecomunicaciones S.A.'s (ENTEL; BBB/Stable) has strengthened due to increased penetration in the Peruvian market and debt reduction. ENTEL benefits from its status as the largest Chilean mobile operator with leading post-paid market share and ARPUs, and continues to operate in two very competitive markets.

ColTel's greater scale and diversified revenue streams compare favorably with Colombian fixed-line provider Empresa de Telecomunicaciones de Bogota, S.A., E.S.P. (BB+/Stable), which has a conservative financial structure.

KEY ASSUMPTIONS

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

--Total revenues growing to COP6.3 billion in 2024 from COP5.8 billion in 2021 with direct costs and competition compressing EBITDA margins to around 21%;

--Mobile subscribers staying flat over the forecast horizon with improving post-paid penetration;

--Mobile ARPUs declining by mid-single digits per year and overall mobile revenues declining by low-to-mid single digits per year;

--Fixed-line subscribers grow high-single digits in 2022 and 2023 due to fiber optic broadband deployment, leading to high-single digit to low double-digit growth. Subscriber and revenue growth moderate in 2024;

--Capex of 11%-14% of revenue, including spectrum renewal;

--Net leverage of around 2.5x.

RATING SENSITIVITIES

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

--A positive action in ColTel's FC IDR is unlikely absent a positive action to Colombia's sovereign rating;

--Total debt/EBITDA falling below 2.00x or net debt/EBITDA falling below 1.75x on a sustained basis due to strengthening of the competitive position and/or FCF being used to pay down debt, along with an improvement in the strength of ColTel's broadband and Pay TV market position could lead to an upgrade in the LC IDR.

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 competitive position, dividends and/or debt-financed acquisitions;

--A downgrade of Colombia's sovereign rating.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Sufficient Liquidity: Liquidity is adequate and supported by consistent operating cash flow generation and a manageable debt amortization profile. The company had cash and equivalents of COP224 billion and it faces no debt maturities until 2024 when COP348 billion of local notes and COP298 billion bank debt are due. ColTel repaid COP526 billion of bank debt due 2023 during 1Q22 with the proceeds from the sale of its fiber optic broadband assets. ColTel's USD500 million 2030 bond is fully hedged, which provides additional financial flexibility.

ISSUER PROFILE

ColTel is an integrated telecommunications provider that offers mobile, fixed voice, Pay TV and broadband services to consumers, businesses, and government customers. The company is 67.5% owned by Telefonica S.A. of Spain and 32.5% owned by the Colombian government.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Colombia Telecomunicaciones S.A. E.S.P.	LT IDR	BBB- Rating Outlook Stable	Affirmed	BBB- Rating Outlook Stable
	LC LT IDR	BBB- Rating Outlook Stable	Affirmed	BBB- Rating Outlook Stable
senior unsecured	LT	BBB-	Affirmed	BBB-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Government-Related Entities Rating Criteria (pub. 30 Sep 2020)

Corporate Rating Criteria - Effective from 15 October 2021 to 28 October 2022 (pub. 15 Oct 2021) (including rating assumption sensitivity)

Sector Navigators - Addendum to the Corporate Rating Criteria - Effective from 15 October 2021 to 15 July 2022 (pub. 15 Oct 2021)

Parent and Subsidiary Linkage Rating Criteria (pub. 01 Dec 2021)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.0.3 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Colombia Telecomunicaciones S.A. E.S.P.	EU Endorsed, UK Endorsed

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