Research Update:

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

March 28, 2023

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Rating Action Overview

- Lower-than-expected cash flows of telecom services provider Colombia Telecomunicaciones S.A. E.S.P. (Coltel) weren't sufficient to fund the renewal of its spectrum licenses. This led the company to finance them through additional debt, causing leverage metrics to weaken from our expectations and current financial risk profile.
- On March 28, 2023, S&P Global Ratings revised its outlook on Coltel to negative from stable and affirmed its 'BB' issuer credit and issue-level ratings on it.
- The negative outlook on Coltel reflects our expectation of weaker credit metrics in the next 12-18 months, with debt to EBITDA above 3x due to a prolonged pressure on cash flows and higher debt amid adverse economic and business conditions.

Rating Action Rationale

We expect Coltel's margins for the next two years to be below the industry average and in line with the change in operating strategy. The company's S&P Global Ratings-adjusted EBITDA margins dropped to 19.2% in 2022 from 29.2% in 2021, below those of peers and the industry average of 30%. This is mainly due to Coltel's overhauled operating model through which it intends to reduce capital expenditures (capex) through higher operating costs for fiber deployment, focusing more on cash generation than on EBITDA margin stability. This is illustrated by 2022 reported capex 45% lower than our expectations, which allowed the company to mitigate the drop in EBITDA. We will continue to evaluate whether cash generation is sufficient to compensate for lower profitability and the company is able to deleverage in the next 12 months.

Coltel's strained credit metrics in 2022 deviate from our deleveraging expectations and could cause a transition to a weaker financial risk profile, if the trend isn't reversed. In 2022, the company generated about COP1 trillion in operating cash, including proceeds from the sale of infrastructure assets to KKR. Coltel used 50% of operating cash for debt amortizations, capex

(40%), and extraordinary dividends (10%). This led the company to seek financing from the Ministerio de Tecnologías de la Información y las Comunicaciones de Colombia (a government entity) to cover the renewal of its 1,900 Mhz spectrum license, increasing the company's adjusted debt by 17% to COP5.4 trillion from our 2022 base-case assumption of COP4.6 trillion. This caused a significant deviation in the company's leverage metrics, with debt to EBITDA rising to 3.6x in 2022 from our expectation of 2.7x. Therefore, our negative outlook on Coltel reflects a higher probability of its financial risk profile remaining pressured in the next 12 months.

Coltel will continue to focus on maintaining market share as the main driver of growth, as well as through its investment in Onnet to maximize its infrastructure. On the other hand, in terms of market share, Coltel remained the second-largest player in Colombia's mobile segment, despite increased competition, including the entrance of WOM S.A. (B+/Stable/--) into the market. Moreover, the company's fiber-to-the-home (FTTH) deployment acceleration positions Coltel as the primary provider in the country with about 3.6 million homes passed with the fastest download speed in the market. In addition, the co-investment agreements and Onnet have allowed the company to accelerate deployment, capture the market opportunity, generate greater value from existing infrastructure, and optimize investments. We believe that these efforts to remain competitive mitigate low selling prices and that, as Coltel increases prices and maintains market share, its cash generation will strengthen.

Outlook

Our negative outlook reflects our view that Coltel will continue to face a competitive market and sluggish economic conditions in the next 6-12 months, which could limit its operating cash flow generation and slow the reduction in debt to EBITDA below 3x.

Downside scenario

We could lower the ratings on Coltel in the next 6-12 months for the following reasons:

- Coltel doesn't reduce debt to EBITDA closer to 3x through higher profitability, suggesting that it continues to struggle with intense competition, slower materialization of cost-reduction strategies, and/or higher cash outflows for operations.
- The company fails to strengthen operating cash flows to cover license renewals and capex, incurring additional debt, weakening leverage metrics and/or eroding the liquidity position.

Upside scenario

We could revise the outlook to stable in the next 12-18 months if there's high certainty that Coltel's cash generation will allow the leverage metric to drop and remain below our 3x threshold on a consistent basis through enhancement of its pricing power, higher subscriber base, and stronger cash generation in order to withstand lukewarm macroeconomic conditions and cover ongoing investment requirements for operations.

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 and 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 1.1% in 2023 and 2.6% in 2024, and Consumer Price Index (CPI) of 11.0% and 4.3%, respectively.
- Colombia's expected economic growth suggest lower-than-expected budget allocations for non-essential services, which we expect to dent Coltel's operations for the next two years. We don't believe that the company can compensate for higher inflation through price increases, as greater competition could reduce Coltel's market share. Therefore, we expect the revenue growth rate to be low for the next two years.
- Coltel's operating currency is the Colombian peso (COP). As of Dec. 31, 2022, about 56% of total debt is denominated in U.S. dollars and the remaining 44% in COP. We believe the company faces low foreign-exchange 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 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:

- A revenue decline of 11.1% to COP7 trillion in 2023 and growth 0.8% to COP7.05 trillion in 2024.
- About 50% of total revenue will continue to come from mobile services for the next two years. This is mainly due to minimal churn rates, slight increases in prices while maintaining the existing market share, and recovery in equipment sales.
- About 45% of total revenue will continue to come 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 that will allow Coltel to differentiate itself from its regional peers in terms of speed and quality of service. Moreover, we expect that paid-TV services will continue to gain prominence through the integration of more streaming applications and through commercial strategies to expand the subscriber base.
- In terms of operating costs, we believe Coltel's operating costs will grow in line with inflation rate and interconnection expenses, given increased traffic and fiber deployment, as well as commercial efforts to attract higher levels of customers and offset competitive pricing. However, we also believe that through digitalization, Coltel will mitigate these effects. The strategy consists of facilitating multiple payment methods and user experience through digital platforms, while improving technical support and customer service and reducing additional operating expenses.
- Adjusted EBITDA will remain flat at about COP1.7 trillion for the next two years.

- Capex to remain in line with the 4G network and fiber deployment, with annual investments reaching about COP600 billion in 2023 and 2024. Moreover, we expect COP200 billion - COP300 billion in 2023 in capex for license renewals if cash generation allows the company to do so. Otherwise, this could be executed through external financing, as was the case in 2022.
- We don't expect dividend payments for the next two years (versus COP95.8 billion in 2022), given our projections that Coltel will focus on preserving liquidity and prudently allocate cash for capex and license renewals.
- We don't expect incremental debt as the company will focus on using its funding sources to cover its investments in 2023. We estimate adjusted debt to remain steady at COP5.5 trillion - COP5.8 trillion for the next two years.

These assumptions result in the following credit metrics for 2023 and 2024:

- Average EBITDA margin of 24%;
- Debt to EBITDA of 3x-4x;
- Funds from operations (FFO) to debt of about 20%; and
- Free operating cash flow (FOCF) to debt below 10%.

Liquidity

We continue to view Coltel's liquidity as adequate because we expect its cash flows and liquidity sources to exceed 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 meet maintenance capex and financial obligations. In addition, we believe that Coltel maintains sound relationship with banks that allowed its capital structure to strengthen, while it has access to financial markets. No large debt amortizations until 2025.

Principal Sources:

- Cash and liquid investments of COP482.4 billion as of Dec. 31, 2022;
- Expected cash FFO of COP951 billion for the next 12 months; and
- Working capital inflows of about COP86.8 billion for the next 12 months.

Principal Uses:

- Scheduled short-term debt maturities of about COP144.8 billion as of Dec. 31, 2022;
- Seasonal working capital of about COP100 billion for the next 12 months; and
- Capex (excluding license renewals) for COP862.5 billion for the next 12 months.

Covenants

As of Feb. 28, 2023, Coltel doesn't have any financial covenants on its debt.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-2

ESG factors have had no material influence on our credit rating analysis of Coltel.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of Dec. 31, 2022, the company reported COP4.9 trillion in total debt, consisting of:

- About COP2.4 trillion in 4.95% senior unsecured notes due 2030;
- COP500 billion in financing from the Ministerio de Tecnologías de la Información y las Comunicaciones de Colombia for the renewal of the spectrum license; and
- About COP2 trillion in bank loans.

Analytical conclusions

We affirmed our 'BB' rating on Coltel's 4.95% senior unsecured notes due 2030, because no other liabilities will exceed the 50% threshold of secured debt to consider a subordination of the notes.

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: Nonstrategic (no impact)

Likelihood of government support: Low (no impact)

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
- Criteria | Corporates | Industrials: Key Credit Factors For The Telecommunications And Cable Industry, June 23, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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; CreditWatch/Outlook Action

	To	From
Colombia Telecomunicaciones S.A. E.S.P.		
Issuer Credit Rating	BB/Negative/--	BB/Stable/--
Ratings Affirmed		
Colombia Telecomunicaciones S.A. E.S.P.		
Senior Unsecured	BB	

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