Research Update:

Telecom Operator Coltel Downgraded To 'B' From 'BB' On Strained Liquidity And Financial Metrics, On CreditWatch Negative

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PRIMARY CREDIT ANALYST

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

SECONDARY CONTACTS

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

Luis Fabricio Gomez
Mexico City
+52 5550814471
luis.fabricio.gomez
@spglobal.com

Rating Action Overview

- Telecom services provider Colombia Telecomunicaciones S.A. E.S.P. (Coltel)'s lower cash flow than we expected, continuous cash outflows, and long- and short-term debt maturities are weighing on liquidity for the next 12 months.
- Moreover, competition, higher costs, and elevated inflation have lowered cash flow and impaired leverage metrics.
- Therefore, on Dec. 18, 2023, S&P Global Ratings lowered its issuer credit and issue ratings on Coltel to 'B' from 'BB' and placed the ratings on CreditWatch with negative implications.
- We aim to resolve the CreditWatch placement and revise the ratings in the next 30-60 days when we have more visibility on the company's ability to secure sufficient funds for refinancing.

Rating Action Rationale

Coltel's lower cash balance, weaker cash generation, and higher short-term maturities increase liquidity risk for the next year, while the company looks for refinancing opportunities through uncommitted credit lines. Lower cash flow generation because of a competitive market and an elastic industry, as well as higher-than-expected capital expenditure (capex) requirements, are straining Coltel's cash balance. Its cash balance reached a historical low of COP50 billion as of Sept. 30, 2023, compared with COP482 billion at the beginning of the year.

In addition, during 2023, the company's share of short-term debt due in the next 12 months has increased, pressuring the maturity schedule. The main maturities include about COP1.2 trillion, including COP350 billion from its local bond due May 2024, and the remaining from bank loans, lease obligations, interests, spectrum license, and mark to market derivatives for the next 12 months.

The cash balance is currently COP283 billion in our estimation, and we expect about COP650 billion in cash generation through operations for the next 12 months. Compared with the reported COP800 billion in short-term debt maturities, as well as COP400 billion in short-term lease obligations for the next 12 months, this suggests potential liquidity risk. However, Coltel has historically maintained ample access to bank lending through uncommitted credit lines. Also, the company expects to renew its current financings, as well as renew others, which would give it greater flexibility to meet its current maturities.

Coltel's profitability has not improved as we expected, weakening its financial leverage metrics, and we do not expect metrics to improve next year. Given a competitive pricing environment, Coltel has shown less flexibility to transfer connection costs, inflation, and Colombian peso depreciation to subscribers, resulting in lower EBITDA generation and deteriorating leverage ratios.

In 2022, Coltel sold its infrastructure assets to ONNET, so we expected connectivity costs to increase and the company to reduce its investments related to such infrastructure. However, costs increased as we expected, but investments remained high due to the company's catch-up on copper transition to fiber optic, to align with 4G deployment.

Coltel's leverage worsened, with debt to EBITDA above 4x and negative free operating cash flow (FOCF) to debt. If Coltel is a 5G spectrum winner, we expect that the financing of this license could also negatively affect its leverage metrics because it will be considered as long-term debt, like what we saw in 2022 with the renewal of its 1,900 mhz spectrum. However, we note that the investments will be split in half between Coltel and Millicom via its joint agreement. Hence, we do not expect full effect on the company, and the conditions seem to be more favorable than the previous spectrum valuations, in our view.

High price competition and inability to make significant investments will continue to impair Coltel's credit profile. The competitive environment continues to affect Coltel's financial results while cash outflows continue. Most telecom operators have entered a vicious cycle of competition. To maintain their market share, they have limited price increases in recent years, unable to compensate for rising inflation, interest rates, operating costs, and investments. Carriers end up compensating for losses by tightening their liquidity positions or taking on more debt. We expect intense competition to continue over the next year.

We now view the comparable ratings analysis as negative, from neutral previously. We add a one-notch negative adjustment in our analysis of Coltel given that its business and financial profiles, as well as its liquidity management, are relatively weaker within their respective categories.

CreditWatch

The CreditWatch negative placement reflects the significant cash outflows, low cash balances, and the COP1.20 trillion in short-term debt and financial lease maturities. Furthermore, we forecast weaker cash flow generation through 2024. Coltel has been stretching the timing of its refinancings, which in our opinion represents aggressive liquidity management. We aim to resolve the CreditWatch in the next 30-60 days when we have more visibility on the company's ability to secure sufficient funds for refinancing.

Downside scenario

We could lower the ratings on Coltel within the next three months by one or more notches for the following reasons:

- We perceive there is higher refinancing risk and/or continued pressure on cash generation.
- The company fails to strengthen operating cash flows for license renewals and capex, incurring additional debt, and/or the company's liquidity erodes further.
- Despite the refinancing, we expect the company will have considerable liquidity deficits in 2024.

Upside scenario

We could remove the ratings from CreditWatch negative and raise the ratings if we have high certainty that Coltel's cash generation and/or future refinancings will allow liquidity to strengthen and if capex commitments do not put further pressure on leverage metrics. In particular, we would look for liquidity sources to meet expected uses for the next year by at least one time (1x). We would also look for a significant decline in leverage, to debt to EBITDA below 4.0x and FOCF to debt toward 10%, on a consistent basis, through enhancements on its pricing power, a larger subscriber base, and stronger cash generation.

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. Telefonica currently 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

Assumptions

S&P Global Ratings' economic assumptions include:

- Our economists expect Colombia GDP growth of 1.2% in 2023 and 1.3% in 2024, and CPI inflation of 11.6% and 5.5%, respectively.
- Colombia's expected economic growth suggest a slower-than-expected reactivation budget allocation for nonessential services, which we expect will continue to hurt Coltel over the next two years. In addition, the company may not be able to compensate for higher inflation rates through price increases, since increased competition could detract from market share. Therefore, we expect revenue growth rates to be low over the next two years.
- As of Sept. 30, 2023, about 55% of total debt is denominated in U.S. dollars and the remaining 45% in local currency (Colombian peso). We believe the company faces low foreign-exchange volatility on its U.S. dollar-denominated debt because it manages the risks using derivative financial instruments on exchange rates and interest rates. Our assessment also considers the net positions of the balance sheet--in order for Coltel 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 will decline 11.1% to COP7.00 trillion in 2023 and revenue will grow 0.8% to COP7.05 trillion in 2024.
- We expect that about 50.0% of total revenues 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 constant market share, and recovered equipment sales.
- About 45% of total revenues 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 enable 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 capture more subscribers.
- We believe Coltel's operating costs will rise in line with inflation rates, owing to labor costs and interconnection expenses given increased traffic and fiber deployment.
- Adjusted EBITDA will total about COP1.45 trillion annually for the next two years.
- Capex will continue going toward 4G network and fiber deployment, reaching investments of about COP600 billion in 2023 and in 2024.
- We do not expect dividend payments for the next two years, given that Coltel likely will focus on preserving liquidity and allocating cash generation into capex, license renewals, and debt maturities.
- We currently do not expect incremental debt while the company has reached minimal cash levels around COP40 billion as of Sept. 30, 2023, so we estimate adjusted debt to remain about COP6.30 trillion over the next two years.

Key metrics

Colombia Telecomunicaciones S.A. E.S.P.--Forecast summary

Industry sector: Diversified telecom

	--Fiscal year ended Dec. 31--								
	2019a	2020a	2021a	2022a	2023e	2024f	2025f	2026f	2027f
(Bil. COP)									
Revenue	5,691	5,360	5,915	7,864	6,989	7,042	7,186	7,405	7,647
EBITDA (reported)	1,915	1,660	1,739	2,442	1,433	1,447	1,471	1,593	1,736
Plus/(less): Other	(332)	(9)	(10)	(932)	--	--	--	--	--
EBITDA	1,583	1,652	1,729	1,510	1,433	1,447	1,471	1,593	1,736
Less: Cash interest paid	(311)	(239)	(356)	(357)	(476)	(461)	(438)	(405)	(380)
Less: Cash taxes paid	(207)	(292)	(379)	(293)	--	--	--	--	--
Funds from operations (FFO)	1,064	1,121	993	859	957	986	1,033	1,189	1,356
EBIT	189	364	349	136	(239)	(239)	(248)	(177)	(88)
Interest expense	217	304	391	489	473	457	434	400	376
Cash flow from operations (CFO)	516	895	1,112	(3)	775	915	974	1,084	1,245
Capital expenditure (capex)	782	1,040	714	431	863	561	589	618	649

Colombia Telecomunicaciones S.A. E.S.P.--Forecast summary (cont.)

Industry sector: Diversified telecom

	--Fiscal year ended Dec. 31--								
	2019a	**2020a**	**2021a**	**2022a**	**2023e**	**2024f**	**2025f**	**2026f**	**2027f**
Free operating cash flow (FOCF)	(266)	(144)	399	(435)	(88)	354	385	466	596
Dividends	70	42	--	96	--	--	--	--	--
Discretionary cash flow (DCF)	(337)	(187)	399	(530)	(88)	354	385	466	596
Debt (reported)	3,160	5,335	4,473	4,914	4,769	4,564	4,346	4,040	4,009
Plus: Lease liabilities debt	886	1,223	1,140	1,455	1,557	1,666	1,783	1,907	2,041
Less: Accessible cash and liquid Investments	(411)	(711)	(548)	(482)	(67)	(40)	(40)	(40)	(454)
Plus/(less): Other	606	14	(17)	(463)	--	--	--	--	--
Debt	4,241	5,860	5,049	5,424	6,259	6,190	6,089	5,908	5,596
Equity	5,974	4,566	5,015	4,729	3,940	3,166	2,406	1,751	1,211
Cash and short-term investments (reported)	411	711	548	482	67	40	40	40	454
(Adjusted ratios)									
Debt/EBITDA (x)	2.7	3.5	2.9	3.6	4.4	4.3	4.1	3.7	3.2
FFO/debt (%)	25.1	19.1	19.7	15.8	15.3	15.9	17.0	20.1	24.2
FFO cash interest coverage (x)	4.4	5.7	3.8	3.4	3.0	3.1	3.4	3.9	4.6
EBITDA interest coverage (x)	7.3	5.4	4.4	3.1	3.0	3.2	3.4	4.0	4.6
CFO/debt (%)	12.2	15.3	22.0	(0.1)	12.4	14.8	16.0	18.3	22.2
FOCF/debt (%)	(6.3)	(2.5)	7.9	(8.0)	(1.4)	5.7	6.3	7.9	10.6
DCF/debt (%)	(7.9)	(3.2)	7.9	(9.8)	(1.4)	5.7	6.3	7.9	10.6
Annual revenue growth (%)	4.0	(5.8)	10.4	33.0	(11.1)	0.8	2.1	3.0	3.3
Gross margin (%)	55.9	55.8	53.6	53.2	42.7	42.7	42.7	43.7	44.9
EBITDA margin (%)	27.8	30.8	29.2	19.2	20.5	20.5	20.5	21.5	22.7
Return on capital (%)	1.9	3.5	3.4	1.3	(2.3)	(2.4)	(2.8)	(2.2)	(1.2)

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. e--Estimate. f--Forecast.

Liquidity

We expect that over the next 12 months, Coltel's cash position and expected operating cash flow will not cover expected increasing lease payments, short-term debt maturities, or capex, without the company refinancing, which has been Coltel's strategy to date. Therefore, we expect that the company's liquidity sources will be able to meet liquidity uses by about 0.5x for the next 12 months, indicating that liquidity is strained.

However, we still believe that Coltel maintains sounds relationship with banks, enabling it to strengthen its capital structure and proving its access to financial markets. As a result, we believe the company could take on additional debt to refinance short-term debt maturities.

Principal liquidity sources:

- Cash and liquid investments of COP50 billion as of Sept. 30, 2023;
- Expected cash FFO generation of COP640 billion for the next 12 months; and
- Working capital inflows of about COP62 billion for the next 12 months.

Principal liquidity uses:

- Scheduled short-term debt maturities of about COP804 billion as of Sept. 30, 2023; and
- Capex of COP636 billion for the next 12 months.

Covenants

As of Sept. 30, 2023, Coltel doesn't have any financial covenants on its debt.

Issue Ratings--Subordination Risk Analysis

Capital structure

As of Sept. 30, 2023, the company's gross debt consists of COP4.39 trillion, of which:

- COP2.017 trillion corresponds to its 4.95% senior unsecured notes due 2030,
- COP500 billion from its local bond due 2024, and
- About COP1.874 trillion from other financial obligations.

Analytical conclusions

We lowered our issue rating on Coltel's outstanding $500 million senior unsecured notes due 2030 to 'B' from 'BB'. 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: B/Watch Neg/--

Business risk: Fair

- Country risk: Moderately high
- Industry risk: Intermediate
- Competitive position: Fair

Financial risk: Aggressive

- Cash flow/Leverage: Aggressive

Anchor: bb-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Less Than Adequate (-1 notch)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile: b

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 22, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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

Downgraded; CreditWatch/Outlook Action

	To	From
Colombia Telecomunicaciones S.A. E.S.P.		
Issuer Credit Rating	B/Watch Neg/--	BB/Negative/--

Downgraded; CreditWatch/Outlook Action

	To	From
Colombia Telecomunicaciones S.A. E.S.P.		
Senior Unsecured	B/Watch Neg	BB

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.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.