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Research Update:

# Telecom Operator Coltel Upgraded To 'B+' On Planned Short-Term Debt Refinancing And Improved Liquidity; Outlook Positive

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## Rating Action Overview

1. Colombia Telecomunicaciones S.A. E.S.P.'s (Coltel's) proposed short-term debt refinancings will alleviate liquidity pressures for the next 12 months.
2. Higher costs and competition will remain the main challenges for Coltel, as it achieves business growth and stronger leverage and liquidity metrics.
3. On April 23, 2024, S&P Global Ratings raised its issuer credit and issue-level ratings on Coltel to 'B+' from 'B' and removed the ratings from CreditWatch with negative implications, where we placed them on Dec. 18, 2023.
4. We assigned a positive outlook on our rating on Coltel, which reflects our expectations that it will continue to strengthen business growth, operating cash generation, and debt refinancing, while improving credit metrics for the next 12-18 months. We expect adjusted debt to EBITDA close to 3x and free operating cash flow (FOCF) to debt of about 10% on a consistent basis.

## Rating Action Rationale

Short-term debt refinancing to ease cash needs for at least the next 12 months. Following our Dec. 18, 2023, rating action on Coltel (Telecom Operator Coltel Downgraded To 'B' From 'BB' On Strained Liquidity And Financial Metrics, On CreditWatch Negative, Dec. 18, 2023), we're removing our ratings from CreditWatch negative and revising our assessment of the company's liquidity to a stronger category. This is mainly based on the proposed refinancings that would allow the company to extend its short-term debt maturity schedule for at least the next 12–15 months.

Coltel plans to refinance COP565 billion in bank loans (out of COP645 billion of debt maturing during 2024) through the following:

5. The COP400 billion bank loan with a bullet maturity in 2027; and
6. The COP165 billion bank loan with a bullet maturity in 2026.

The company also plans to refinance COP775 billion in bank loans (out of the COP1.1 trillion of debt maturing during the first quarter of 2025) through maturity reprofiling with current financial institutions, out of which the company has negotiated about half of the total amount.

For another upgrade to occur, we would like to see a continuity in leverage metrics for the next 12-24 months, in line with the expected operating cost efficiencies and consistent revenue generation. Excluding nonoperating asset sales, Coltel's revenue increased by 2% to COP7.1 trillion during 2023 from COP6.9 trillion in 2022, while EBITDA remained flat year over year at COP1.5 trillion. On the other hand, adjusted debt rose 7.8% to COP5.6 trillion in 2023 from COP5.2 trillion in 2022, primarily due to higher lease obligations and lower accessible cash. As a result, adjusted debt to EBITDA climbed to 3.7x by the end of 2023 from 3.4x in 2022, while FOCF to debt weakened to about 7.2% from 22.7%. Our base-case scenario assumes that the leverage metric will drop slightly below 3x by 2025, depending on Coltel's ability to strengthen revenue, profitability, as well as cash balance. We don't expect substantial debt reduction, aside from lease payments, for the next 24 months.

Our negative comparable rating analysis assessment continues to incorporate our view that the company's financial, business and liquidity profiles are at the lower end of the current scoring. We will continue to evaluate the company's ability to strengthen leverage metric, market position, and cash generation.

7. Coltel failed to deliver expected EBITDA, debt reduction, and stronger cash position for the past two years. According to our methodology, if the company's results continue to deviate from our expectations, we could revise our financial risk profile assessment to a weaker category.

8. The company refrains from aggressively increasing prices in order not to lose market share, causing revenue growth to slow. Moreover, even though Coltel shifted its strategy after divesting its fiber assets, EBITDA margins remained at 21% and return on capital close to 3%, below the industry average. We could revise our assessment of Coltel's business risk profile to a lower category stemming from weaker operating efficiencies if the company is unable to increase sharply its scale and/or lower operating costs.

# Outlook

The positive outlook reflects our view that Coltel has shown stronger metrics than our previous expectations. However, we would need to see a continuity and consistency of cash generation through operations (excluding extraordinary asset sales and others) for us to revise our assessment of the Coltel's financial risk profile to a stronger category. In order for us to maintain the current business risk profile assessment, we expect the company to continue focusing on strengthening market share and increasing subscriber base, allowing for higher absorption of operating costs, while also reducing capital expenditure (capex) for fiber deployment. For the next 12-18 months, we expect the company to post debt to EBITDA close to 3x and FOCF to debt of about 10%.

## Downside scenario

We could revise the outlook back to stable and/or downgrade Coltel in the next 12 months for the following reasons:

9. Liquidity pressures rise from short-term debt maturities, cash shortfalls, and/or higher-than-expected cash expenses, leading the company to rely on higher debt or refinancings, which could suggest weaker risk management and/or unsustainable debt; or

10. The company fails to strengthen operating cash flow, raising debt to EBITDA toward 4x, while FOCF to debt remains below 10%; or

11. The company deviates from the current projected scenario, suggesting a weaker business risk profile.

## Upside scenario

We could upgrade Coltel in the next 12-18 months if it does the following:

12. Maintain debt to EBITDA close to 3x, while strengthening FOCF to debt above 10%; and
13. Posts higher-than-expected operating revenue that suggests a favorable trend in business dynamics; and
14. Demonstrates business efficiencies through consistently higher EBITDA, maintains adequate liquidity sources, and covers capex and working capital needs without requiring additional debt and/or reducing cash balance by year-end.

# 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:

- Colombia's GDP growth of 1.3% in 2024 and 2.8% in 2025, and consumer price index (CPI of 5.5% and 3.6%, respectively.
- Colombia’s low economic growth and higher inflation rates could suggest higher elasticity for the telecom industry, as higher prices may take a toll on the customer base.
- The company won't be able to compensate for higher inflation through price increases, as aggressive competition could reduce market share. We expect revenue growth to stem from market share/subscriber increases for the next two years.
- Coltel's operating currency is the Colombian peso (COP). On pro forma basis, as of Dec. 31, 2023, about 41% of total debt is denominated in U.S. dollars and the remaining 59% is in pesos. The company faces low foreign-exchange volatility on its U.S. 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 1.8% to COP7.2 trillion in 2024 and 2.5% to COP7.4 trillion in 2025, in line with our current economic growth rates for Colombia for both years.
- About 45% of total revenue will continue to come from mobile services and 48% from fixed services for the next two years.
- Operating costs will grow in line with inflation, consisting of labor costs and interconnection expenses linked to expected increased traffic. Consistent realization of efficiencies in noncommercial costs and expenses to allow steady profitability margins.
- Adjusted EBITDA of COP1.57 trillion - COP1.65 trillion annually for the next two years.

- Capex to remain in line with the 4G network and fiber deployment, totaling about COP580 billion in 2024 and COP600 billion in 2025, approximately 8% of total revenue.
- No dividend payments for the next two years, given our expectations that Coltel will focus on preserving liquidity position and prudently allocate cash generation for capex, license renewals, and debt maturities.
- No additional debt, given ongoing refinancings, and gross debt reduction by COP50 billion from spectrum license amortizations. Adjusted debt to remain at COP5.7 trillion - COP5.8 trillion for the next two years.

## Key metrics

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

| Period ending | --Fiscal year ended Dec. 31-- | | | | | |
|---|---|---|---|---|---|---|
| (Bil. COP) | 2021a | 2022a | 2023a | 2024e | 2025f | 2026f |
| Revenue | 5,911 | 7,864 | 7,123 | 7,249 | 7,431 | 7,666 |
| EBITDA (reported) | 1,742 | 2,442 | 1,561 | 1,574 | 1,633 | 1,710 |
| Plus/(less): Other | (10) | (932) | (48) | -- | -- | -- |
| EBITDA | 1,732 | 1,510 | 1,512 | 1,574 | 1,633 | 1,710 |
| Less: Cash interest paid | (326) | (445) | (537) | (535) | (502) | (453) |
| Less: Cash taxes paid | (374) | (282) | (282) | -- | -- | -- |
| Funds from operations (FFO) | 1,033 | 782 | 693 | 1,038 | 1,131 | 1,257 |
| EBIT | 352 | 203 | 270 | 273 | 300 | 335 |
| Interest expense | 391 | 489 | 614 | 536 | 506 | 453 |
| Cash flow from operations (CFO) | 1,803 | 1,609 | 1,216 | 1,035 | 1,162 | 1,287 |
| Capital expenditure (capex) | 712 | 431 | 815 | 579 | 597 | 615 |
| Free operating cash flow (FOCF) | 1,091 | 1,178 | 401 | 455 | 565 | 672 |
| Dividends | -- | 96 | -- | -- | -- | -- |
| Discretionary cash flow (DCF) | 1,091 | 1,082 | 401 | 455 | 565 | 672 |
| Debt (reported) | 4,473 | 4,914 | 4,541 | 4,216 | 3,911 | 3,081 |
| Plus: Lease liabilities debt | 1,136 | 1,455 | 1,631 | 1,623 | 1,542 | 1,542 |
| Less: Accessible cash and liquid Investments | (605) | (609) | (362) | (374) | (566) | (336) |
| Plus/(less): Other | (221) | (581) | (226) | (199) | (199) | (199) |
| Debt | 4,783 | 5,179 | 5,584 | 5,266 | 4,688 | 4,088 |
| Cash and short-term investments (reported) | 605 | 609 | 362 | 374 | 566 | 336 |
| **Adjusted ratios** | | | | | | |
| Debt/EBITDA (x) | 2.8 | 3.4 | 3.7 | 3.3 | 2.9 | 2.4 |
| FFO/debt (%) | 21.6 | 15.1 | 12.4 | 19.7 | 24.1 | 30.8 |
| FFO cash interest coverage (x) | 4.2 | 2.8 | 2.3 | 2.9 | 3.3 | 3.8 |
| EBITDA interest coverage (x) | 4.4 | 3.1 | 2.5 | 2.9 | 3.2 | 3.8 |
| CFO/debt (%) | 37.7 | 31.1 | 21.8 | 19.7 | 24.8 | 31.5 |
| FOCF/debt (%) | 22.8 | 22.7 | 7.2 | 8.6 | 12.0 | 16.4 |
| DCF/debt (%) | 22.8 | 20.9 | 7.2 | 8.6 | 12.0 | 16.4 |
| Annual revenue growth (%) | 10.3 | 33.0 | (9.4) | 1.8 | 2.5 | 3.2 |
| Gross margin (%) | 53.8 | 53.2 | 48.0 | 47.8 | 48.1 | 48.4 |
| EBITDA margin (%) | 29.3 | 19.2 | 21.2 | 21.7 | 22.0 | 22.3 |
| Return on capital (%) | 3.5 | 2.1 | 2.8 | 3.0 | 3.6 | 4.4 |

All figures include S&P Global Ratings adjustments' unless stated as reported. a--Actual. e--Estimate. f--Forecast.

# Liquidity

We're revising our assessment of Coltel's liquidity to adequate from less than adequate based on the company's proposed refinancings to reduce short-term debt liabilities, while seeking higher cash generation from operations. Therefore, we now expect the company's liquidity sources to cover about 1.2x of uses for the next 12 months, even if EBITDA were to decline 15%. We believe Coltel maintains sound relationship with banks that have allowed for ongoing refinancings and access to financial markets when needed. We will continue to monitor future refinancings.

## Principal liquidity sources

- Cash and liquid investments of COP363 billion as of Dec. 31, 2023;
- Expected cash funds from operations of COP780 billion for the next 12 months;
- Working capital inflows of about COP19 billion for the next 12 months; and
- Expected funds from refinancing bank loans to cover debt maturities of the upcoming 18 months of COP1.3 trillion.

## Principal liquidity uses

- Scheduled short-term debt maturities of COP815 billion as reported on Dec. 31, 2023; and
- Capex of COP580 billion for the next 12 months.

# Covenants

## Requirements

As of Dec. 31, 2023, Coltel doesn't have any financial covenants on its debt.

## Compliance expectations

Since Coltel does not have any active covenants, the company is under compliance.

# Environmental, Social, And Governance

ESG factors are neutral to our analysis on Coltel.

# Issue Ratings--Subordination Risk Analysis

## Capital structure

As of Dec. 31, 2023, the company's gross debt consists of COP4.541 trillion, of which:

- COP1.902 trillion corresponds to its 4.95% senior unsecured notes due 2030;
- COP500 billion in local bonds due 2024 and 2029; and
- The remainder corresponds to other financial obligations.

## Analytical conclusions

We raised our issue-level rating on Coltel's outstanding $500 million senior unsecured notes due 2030 to 'B+' from 'B', in line with our issuer credit rating, because no other liabilities will exceed the 50% threshold of secured debt to consider a subordination of the notes.

### Rating Component Scores

| | |
|---|---|
| **Foreign currency issuer credit rating** | B+/Positive/-- |
| **Local currency issuer credit rating** | B+/Positive/-- |
| **Business risk** | Fair |
| Country risk | Moderately High |
| Industry risk | Intermediate |
| Competitive position | Fair |
| **Financial risk** | Aggressive |
| Cash flow/leverage | Significant |
| **Anchor** | bb- |
| Diversification/portfolio effect | Neutral (no impact) |
| Capital structure | Neutral (no impact) |
| Financial policy | Neutral (no impact) |
| Liquidity | Adequate (no impact) |
| Management and governance | Neutral (no impact) |
| Comparable rating analysis | Negative (-1 notch) |
| **Stand-alone credit profile** | b+ |

## Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- 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
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

# Ratings List

## Ratings list

**Upgraded; Outlook Action**

| | To | From |
|---|---|---|
| **Colombia Telecomunicaciones S.A. E.S.P.** | | |
| Issuer Credit Rating | B+/Positive/-- | B/Watch Neg/-- |
| Senior Unsecured | B+ | B/Watch Neg |