



Rating_Action: Moody's downgrades Telefonica del Peru to B2 concluding the review; negative outlook

24Mar2023

New York, March 24, 2023 -- Moody's Investors Service ("Moody's") today downgraded Telefonica del Peru S.A.A.'s ("Telefonica del Peru") Corporate Family Rating (CFR) and senior unsecured ratings to B2 from Ba3 and changed the outlook to negative from rating under review.

Downgrades:

..Issuer: Telefonica del Peru S.A.A.

.... Corporate Family Rating, Downgraded to B2 from Ba3

....Senior Unsecured Regular Bond/Debenture, Downgraded to B2 from Ba3

Outlook Actions:

..Issuer: Telefonica del Peru S.A.A.

....Outlook, Changed To Negative From Rating Under Review

RATINGS RATIONALE

The downgrade to B2 reflects Telefonica del Peru's persistently weak operating performance, which has been consistently below Moody's original expectations and the average for industry peers. Despite the recent improvement in cost structure and recovery in service revenues when compared to pandemic lows, Moody's believes that operating performance will remain pressured over the next 12-24 months given the intense market competition and challenging macroeconomic environment in Peru. EBITDA margin, as adjusted by Moody's, is expected to remain around 22.5% over the next 12-24 months. Although an improvement when compared to the 19.5% reported in 2021, this level is low when compared to peers and the company's own pre-pandemic levels of 24.5% in 2019 and 36.4% in 2016, when competition from new entrants was limited.

In addition, Moody's expects deterioration in liquidity and leverage over the rating horizon given the need to settle a large tax dispute with the tax authority, SUNAT. This settlement is estimated at about PEN2.8 billion (USD 718 million), according to the company's provisions on balance sheet. Although the timing and terms of this settlement are still not finalized, a significant portion of the amount due will need to be settled over the course of 2023 pressuring the company's liquidity and leverage. Despite the additional liquidity provided by Telefonica del Peru's main shareholder, Telefonica Hispanoamerica, in the form of a convertible intercompany loan, Moody's expects a significant portion of the settlement to be debt-financed, further increasing Moody's adjusted leverage to around 4.0x in 2023, up from 2.6x as of December 2022.

This action concludes the review for downgrade initiated in December 2022 to assess Telefonica del Peru's progress towards improving margins and FCF generation and its plans to secure financing sources to timely meet the tax settlement with the SUNAT, as well as for upcoming debt amortizations and capex needs.

The negative outlook considers Telefonica del Peru's challenges to continue improving profitability in the context of intense competition and a challenging economic environment with expected high inflation, FX volatility, persistent unemployment, and political instability. Furthermore, the negative outlook considers the increase in liquidity risk stemming from the short-term cash needs to face the SUNAT settlement and upcoming debt amortizations. Moody's expects the company to need to raise debt in the near-term to face these obligations.

Although Telefonica del Peru benefits from its scale as the largest telecommunications operator in Peru, the company faces significant competitive challenges to revert the deterioration in operating metrics and loss of market share that started in 2014 with the entry of two new and aggressive competitors that disrupted the competitive landscape. This persisted until recently, aggravated by the coronavirus pandemic. To combat this trend, the company has executed a well-defined strategy to prioritize profitability growth, focusing on cost reductions, as well as on improvements in the commercial strategy to reduce churn and grow revenue. Throughout 2022, this new strategy delivered modest but steady improvements in profitability. Moody's-adjusted EBITDA margin increased to 22.4% in 2022, which negatively compares with the 24.5% reported as of year-end 2019 but is an improvement when compared to the 19.5% reported in 2021.

Telefonica del Peru posted negative free cash flow as adjusted by Moody's in 2022, a trend that Moody's expect to continue in 2023 given their need to continue to invest to maintain competitiveness and expand network coverage. Moody's believes low capital intensity increases the risk of technological obsolescence and may undermine the company's competitive position over time. The rating agency forecasts 2023 capex to be slightly below 10% of revenues.

As of December 2022, Telefonica del Peru had PEN433 million (\$124 million) in cash on hand, which was sufficient to cover its debt maturities until 2023. However, Moody's expects the cash position to deteriorate over the course of 2023 due to the settlement of tax liabilities with the SUNAT. Moody's expects a significant portion of this settlement to be debt-financed, increasing leverage from around 2.6x in December, to about 4.0x.

Following the Supreme Court's decision in favor of the SUNAT in January 2023, Telefonica del Peru's shareholders determined that the company will seek additional financing and potential additional capital contributions to service these payments. In February, the Board of Directors approved a PEN1 billion (\$265 million) convertible loan from Telefonica Hispanoamerica to Telefonica del Peru, of which PEN365 million (\$92 million) was disbursed immediately.

Since 2019, Telefonica del Peru's ultimate parent company, Telefonica S.A. (Baa3 stable), has prioritized markets where it perceives long-term sustainable growth and has worked to spinoff of its businesses in Hispano America, including Telefonica del Peru. Given this context, the rating incorporates no support from the parent.

Governance factors are important considerations for Telefonica del Peru's rating and reflect the company's operating track record, which has been impacted by loss of profitability and market share since 2014, as well as the company's tolerance for higher liquidity risk and leverage resulting from the tax settlement with the SUNAT.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

An upgrade is unlikely at this point given the negative outlook. However, Moody's could stabilize the rating outlook if there is strong evidence that the company will be able to sustain positive revenue growth and steady improvement in profitability over the rating horizon, while maintaining leverage below 3.5x and interest coverage measured by (EBITDA-CAPEX)/Interest Expense at 2.5x or higher on a sustained basis. In addition, the company needs to demonstrate adequate liquidity and the ability to secure financing to timely meet the tax settlement with the SUNAT as well as upcoming debt amortization and capex needs.

The ratings could be downgraded if there is further deterioration in liquidity due to persistent negative free cash flow generation driven by weaker performance, higher capex needs, or additional claims related to the company's tax proceedings. Ratings could also be downgraded if the company is not able to secure financing to meet SUNAT obligations or leverage is expected to increase to a level higher than 4.0x without a clear path for deleveraging.

Telefonica del Peru is the largest telecommunications company in Peru, with a mobile market share of around 30% and 54.5% in the fixed internet segment as of December 2022, according to the Peruvian telecommunications regulator – OSIPTEL. The company is an integrated telecommunications service provider offering mobile, fixed, pay-TV and business-to-business services through its Movistar brand. Telefonica del Peru is Peru's largest telecommunications company in terms of revenue, and a leader in all segments, with more than 12.6 million revenue-generating units (RGUs) in mobile and almost 3.3 million RGUs in fixed broadband and pay TV. In 2022, the company generated revenue of around PEN7.17 billion (\$1.8 billion). Telefonica del Peru is controlled by Telefonica Hispanoamerica which indirectly holds 98% of its shares. The remaining are traded on the Lima Stock Exchange – Bolsa de Valores de Lima.

The principal methodology used in these ratings was Telecommunications Service Providers published in September 2022 and available at <https://ratings.moodys.com/api/rmc-documents/393391>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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