

RATING ACTION COMMENTARY

Fitch Downgrades Telefonica del Peru's IDRs to 'B+'; Outlook Remains Negative

Wed 21 Feb, 2024 - 17:36 ET

Fitch Ratings - Chicago - 21 Feb 2024: Fitch Ratings has downgraded Telefonica del Peru S.A.A.'s (TdP) Long-Term Foreign and Local Currency Issuer Default Ratings (IDR) to 'B+' from 'BB-' and senior unsecured PEN1.7 billion notes to 'B+'/'RR4' from 'BB-'. The Rating Outlook is Negative.

The downgrade and Negative Outlook reflect weak 2023 operating performance and the near-term materialization of TdP's tax liability. The tax liability will result in a material deterioration of TdP's leverage profile (including tax contingent obligation) in 2024. In addition, the company continues to operate in an intense competitive environment amid an uncertain economic backdrop in Peru. While TdP benefits from its scale as the largest operator in Peru, and diversified product portfolio, the company's negative FCF has weighed on its financial profile.

KEY RATING DRIVERS

Outstanding Tax Liability: As of Dec. 31, 2023, TdP has not finalized its required tax payment to SUNAT, Peru's tax agency. The final amount is pending a judicial decision, expected in the coming months. Fitch expects the total amount to be around PEN3.0 billion, a portion of which has already been paid in 2023 using funds from the PEN1.0 billion shareholder loan disbursed in 2023. Peruvian companies facing tax liabilities have the option to extend a portion of the final settlement payment up to six years by following standard procedures with the SUNAT.

Fitch expects the company will seek additional debt financing to service these payments (in addition to the capitalization of shareholder loans which have already been disbursed), and this will affect the company's financial profile.

Leverage Expected to Worsen: Fitch expects leverage to weaken over the rating horizon, given the expectation that a portion of the tax payments will be financed with debt financing. Positively, TdP has already received disbursements of a shareholder loan

of PEN1 billion from Telefonica Hispam, a portion of which has already been equitized as of December 2023. Fitch assumes some further shareholder support, but to what extent remains uncertain.

Relatively Weak Profitability, Negative FCF: Fitch expects FCF to remain negative and continue to weigh on the company's financial profile. Mobile and fixed revenue have both declined around 10% in 2023 as of result of intense competition. EBITDA margin declined to around 11% in 2023 from 15% in 2022 mainly as a result of lower revenues. Fitch expects an acceleration of fiber rollout and low single digit ARPU growth to offset declining HFC and fixed voice, generating revenue growth in the low single digits for the fixed business over the rating horizon.

Strong Diversification: TdP's business profile, particularly in terms of diversification, remains solid. It is well-diversified between fixed (47%) and mobile service (53%) offerings despite market share losses in recent years due to intense competition, most notably on the mobile side as Entel and Bitel (Viettel Group) continue to attract customers.

Linkages with Telefonica S.A.: Fitch rates TdP on a standalone basis due to the low legal, strategic, and operational incentives as related to the ultimate parent Telefonica S.A. (TEF; BBB/Stable). TDP represents less than 3% of Telefonica's total EBITDA. However, Fitch expects Telefonica Hispam to provide some support to the company if needed to address the company's tax liability

DERIVATION SUMMARY

Compared to regional peers, TdP has a well-diversified business, but the company's market position and profitability have been weakened as a result of intense competition in Peru. The company's financial profile has deteriorated since 2016 and cash flows are expected to be further pressured by weak operating performance. Additionally, leverage is expected to be elevated as a result of the tax liability, which Fitch expects will be partially funded with debt financing.

TdP's business position is roughly in line with sister company Telefonica Moviles Chile (TCH, BBB-/Stable) in terms of service diversification and market position. TMCH is stronger financially, supported by lower leverage, while TdP has consistently lost share in both mobile and fixed, which has weighed on its profitability.

TdP is rated four notches below competitor Entel (BBB-/Stable), as Entel has capitalized on its improved scale in Peru and sustained its strong operational performance in Chile. Although TdP's large fixed-line presence supports its business position in Peru, Entel has

a superior financial profile due to the continued strength in its Chilean operations and improving profitability metrics in Peru.

Compared with regional peers in the 'B' rating category, TdP's business position is toward the high end of the category. Compared to 'B' category peers, Wom Mobile (B-/Rating Watch Negative) and Total Play (B-/Rating Watch Negative) TdP has a stronger liquidity position and more diversified business profile.

KEY ASSUMPTIONS

- Revenue growth in the low single digits over the rating horizon;
- Low-single-digit growth in mobile subscribers and growth in ARPUs;
- Fixed revenues remaining relatively flat, near PEN3.2 billion over the rating horizon;
- Continued double-digit declines in fixed-line voice subscribers, partially offset by broadband subscribers growing in the low single digits, with fixed ARPUs growing in the low-single-digit percentage range;
- EBITDA margins gradually improving to around 13% in the rating horizon;
- Capital expenditures around 10% of revenues;
- Material tax payments pressure FCF over the rating horizon;
- Company will partially refinance debt in 2025 and 2026;
- Expectation of some shareholder support from Telefonica Hispam to help pay tax liability.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Positive Rating

Action/Upgrade:

- Stabilization of the ratings is dependent on the company achieving stability in market position and margin expansion above forecasts;
- Sustained neutral or positive FCF generation;
- Significant shareholder support from the parent resulting in leverage stabilizing would be positive for the rating.

Factors that Could, Individually or Collectively, Lead to Negative Rating

Action/Downgrade:

--Continued deterioration of margins and competitive position regardless of credit metrics;

--Total debt/EBITDA sustained above 5.5x or net debt/EBITDA above 5.0x;

--Inability to generate positive FCF on a sustained basis;

--Unfavorable financing structure of tax payments.

LIQUIDITY AND DEBT STRUCTURE

Uncertain Liquidity: As of Dec. 31, 2023, the company had PEN297 million in short-term debt, and readily available cash of PEN521 million. TdP benefits from its manageable amortization schedule, with the majority of its debt maturing beyond 2025, including its PEN1.7 billion note due in 2027. However, projected negative FCF, including the impact of material tax payments, implies that the company will need to secure external debt financing in the near term, assets sales, and/or further shareholder support in the near term. Positively, the company's existing debt is completely payable in Peruvian soles, limiting foreign exchange risk for the company.

ISSUER PROFILE

Telefonica del Peru S.A.A. is the largest integrated telecom operator in Peru in terms of revenue share. The company provides mobile and fixed-line telephony, broadband and Pay-TV through its Movistar brand, as well as IT solution services for corporate clients.

SUMMARY OF FINANCIAL ADJUSTMENTS

Standard lease adjustments

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

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process;

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RATING ACTIONS

ENTITY / DEBT ⚡	RATING ⚡			RECOVERY ⚡	PRIOR ⚡
Telefonica del Peru, S.A.A.	LT IDR				BB- Rating Outlook Negative
	B+ Rating Outlook Negative				
	Downgrade				
	LC LT IDR				BB- Rating Outlook Negative
	B+ Rating Outlook Negative				
	Downgrade				
senior unsecured	LT	B+	Downgrade	RR4	BB-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Parent and Subsidiary Linkage Rating Criteria (pub. 16 Jun 2023)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 03 Nov 2023)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Telefonica del Peru, S.A.A.

EU Endorsed, UK Endorsed

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