Industry Top Trends 2021

Telecommunications

Leverage Risk Transcends Pandemic Resilience

What's changed?

The pandemic underscores broadband’s value. Stay and work-at-home and social distancing is shining a light on broadband’s importance to the modern economy, which bodes well for vested carriers in the long run.

Sector resilient, but not immune. 2020 closures and lower mobility will weigh on sector earnings through early-2021. Carriers, however, are protecting margins, delivering solid free operating cash flow, and retaining financial flexibility and market access.

5G delays provide financial flexibility. 5G auction delays are allowing balance sheet repair, but defer material 5G-led growth beyond 2021. Potential regulatory bias supporting network resilience and innovation could favor providers.

What are the key assumptions for 2021?

Higher revenue and cash flow. We expect growth resumption by the second half of 2021 from higher loadings, wireless roaming, and upselling new services. Digital transformations could offset marketing spend, protecting profitability.

Asset rationalization could help fund capex. Capital allocation will continue to be a focus for many operators. We expect asset monetization and a refocus on core business to support investment in long-lead fiber and 5G.

Telco deleveraging will take time. 5G spectrum, investments in fiber and information technology, and dividend payouts amid modest cash flow growth preclude debt reduction or a significant sustained improvement in leverage.

What are the key risks around the baseline?

The challenge of delivering adequate returns. Competition, service commoditization, and pro-consumer regulatory policies could preclude an adequate return on large investments.

A prolonged recession could thwart deleveraging. A failure to recover from the pandemic amid vaccine delays could stall earnings growth and pressure leverage.

5G-led growth remains elusive. Carrier inability to differentiate and monetize 5G investments amid limited differentiation and distant use cases is a challenge.
Ratings trends and outlook

Global Telecommunications

Chart 1
Ratings distribution

Chart 2
Ratings distribution by region

Chart 3
Ratings outlooks

Chart 4
Ratings outlooks by region

Chart 5
Ratings outlook net bias

Chart 6
Ratings net outlook bias by region

Global Telecoms

Ratings trends and outlook

In 2020, the telecommunications sector demonstrated its relative resilience with pandemic- and oil price shock-led negative rating actions representing only 22 issuers (15% of rated universe) compared to more than 2,080 actions across corporate and sovereigns globally. Overall, 74% of telecom issuers continue to have a stable outlook (see chart 3), and the proportion of companies with a negative trend improved marginally to 21% from 23% last year. Masking the prospective credit trend improvement, however, is a slight negative shift in the overall credit quality (see chart 1). Heading into 2021, the industry’s credit quality is beginning to get cloudier given its relatively high debt leverage (compared to historical measures) and planned investments in 5G and fiber densification. However, industry consolidation and the adoption of digital processes coupled with growth from new services, and presumably credit-supportive policies, could provide ratings stability.

For the most part, investment-grade (IG) issuers should fare well. And while we expect to be patient with such high-grade issuers given their strong business attributes, many of these companies went into 2020 with modest leverage headroom, and a slower pace of deleveraging (and sovereign-linkages in the case of Mexican operators) is pushing our net outlook bias to negative. We do not foresee any potential fallen angels, although some rising stars could emerge over the next few years owing to industry consolidation. Speculative-grade (SG) issuers, particularly those with limited scale and differentiation or companies indexed to legacy offerings or high investment needs amid weak balance sheets remain most vulnerable to negative actions in the coming year.

Regionally, credit quality in North America and Europe is stabilizing while our outlook bias for Asia-Pacific and Latin America is trending negatively given the effects of intense competition, high leverage, mergers and acquisitions (M&A), sovereign or parent-linkage risks. In the U.S., more than 80% of ratings have a stable outlook, and the modest improvement in the net negative outlook bias reflects recent refinancing activity, which has enabled SG issuers to push out maturities. Still, almost a high-teens percentage of the ratings have a negative outlook or are on CreditWatch with negative implications and the pressure on ratings for these issuers comes from secular industry declines in wireline, integration missteps in acquisitions among data center and fiber providers, and slowing growth. Notable rating actions in 2020 included lowering the ratings on T-Mobile US to ‘BB’ with a stable outlook from ‘BB+’ following its acquisition of Sprint. Our credit outlook for the Canadian telecom & cable issuers is mixed given reduced debt leverage headroom for the three largest providers (Telus Corp. has a negative outlook), but a constructive ratings view of the regional cable operators given their improving leverage and favorable near-term growth outlook from wireless.

In Europe, rating outlooks weakened during 2020, from a relatively strong position in 2019. Tight leverage headroom at several operators, such as Telefonica (lowered to BBB-/Stable on Nov. 20) and Telecom Italia (BB+/Negative) was eroded by COVID-19 headwinds as well as inorganic drivers, including M&A. However, ratings pressure is stabilizing with the number of negative outlooks and CreditWatches moderating to less than 20% of our ratings. Europe has a relatively balanced mix of positive and negative outlooks, and amongst the highest percentage of stable outlooks, near 75%. Assuming a macroeconomic recovery supports return to sector growth, we assume further credit stabilization in 2021.

At close to 35%, Latin America (LatAm) has the largest percentage of issuers with negative rating outlooks or a rating on CreditWatch with negative implications, primarily in the speculative-grade category. Conversely, most IG issuers remain resilient to the pandemic and, with balance sheets in check, we do not anticipate many rating actions, at
least on a stand-alone basis. Nonetheless, some of these issuers face sovereign caps or are constrained by a parent company such as Telefonica Moviles Chile and Telefonica Chile, which were recently downgraded owing to Telefonica S.A. In the case of Argentina, credit quality for the sector is weighted by tighter central bank regulations on accessing foreign exchange. We've also identified large global players with a presence in Latin America, seeking to divest certain operations, which could point to a lower commitment of extraordinary support, potentially diminishing the credit quality of some providers.

Rating trends in Asia-Pacific (APAC) are also comparatively negative with more than 20% of rated issuers on negative outlook. This is mainly attributable to stiff competition in many regions, the impact of COVID-19, and ongoing large capital spending needs for advanced network deployment. In 2020 we downgraded eight APAC telcos and upgraded none. The downgrades included Nippon Telegraph & Telephone Corp. (NTT), and its mobile communications subsidiary NTT Docomo Inc., following NTT's debt-financed takeover of NTT Doicom. Earlier this year we had also downgraded Singapore Telecommunications Ltd. (Singtel) and its Australian subsidiary Singtel Optus Pty Ltd., reflecting the strong competitive headwinds that Singtel faces in its key markets of Singapore and Australia.

Main assumptions about 2021 and beyond

1. Broadband strength should support recovery in 2021
Robust ongoing demand for fixed broadband coupled with recovery in consumer wireless should propel revenue and earnings growth across most regions.

2. 5G deployments on mid-band spectrum could drive device upgrades
We expect 5G penetration to expand in 2021 as additional markets and coverage are added on more efficient mid-band spectrum, improving customer experiences.

3. High telco capital expenditures (capex) and spectrum purchases will constrain leverage improvement
Wireless and fiber investments for 5G (4.5G in LatAm) and converged strategies will keep industry spending high, while cable capex intensity will continue to ease as companies de-emphasize customer premise equipment associated with video in favor of broadband.

Revenue growth recovers in 2021
The global pandemic demonstrated that telecom and cable is a resilient sector, but not immune to the economic fallout. Overall, we expect revenue erosion of 0%-4% across several regions in 2020, with wireless and small- and midsize- business (SMB)-exposed companies most affected. Also, issuers indexed to the travel and hospitality sectors, including some satellite companies, are facing revenue headwinds. Issuers with integrated traditional media operations saw pressure due to lower advertising revenues waned and limited new content, despite strong viewership from stay-at-home advisories.

Revenue from wireless services varied regionally (from flat to down 5% for service revenue) reflecting domestic pandemic response and success in containing the virus. Revenue pressure arose as profitable roaming and overage revenue declined from reduced business and consumer mobility as well as from lower device sales (although handsets and other devices are not profitable to the carriers). Prepaid revenues also diminished in several markets owing to lower usage, retail closures, and economic hardship. Meanwhile, retail store closures and weaker sentiment in the first half of the year hurt activations, denying carriers an opportunity to upgrade customers to higher value subscriptions—a dynamic that impairs near-term growth but could arguably
benefit the industry from pent-up demand in 2021. Nonetheless, wireless’ resilience was supported by its mature base with lower attrition (churn), which along with lower selling and marketing costs allowed operators to protect margins and sustain robust free cash flow.

Stay-at-home advisories, remote-working, and e-learning led to a marked and likely sustainable shift in broadband consumption. Homebound consumers increased their reliance on high speed internet (HSI) services for their information and entertainment needs, spurring non-peak broadband consumption by as much as 50% in some markets early in the pandemic. Broadband utilization still remains an estimated 20%-25% higher than pre-pandemic levels. Demand for new broadband activations is robust and we are seeing ongoing upgrade interest from consumers. We believe this change bodes well for entrenched internet service providers (ISPs) such as cable companies in North America and also validates telecom fiber-based convergence strategies elsewhere. As such, we have a favorable view of the ISPs’ near-term opportunity to derive more value from their broadband assets, although we acknowledge this is subject to regulatory frameworks (and level of competition) remaining supportive for the providers.

Still, ongoing pressure from legacy revenues such as voice, copper-based data services, and linear-video cord cutting and shaving, could accelerate through the pandemic-led recession, while some erosion in SMB revenue represents permanent scars tempering growth. Nevertheless, we expect revenues to improve in 2021 as widespread vaccine availability supports increased mobility, promoting greater consumer confidence and economic recovery. Separately, the potential to upgrade to 5G wireless as coverage and throughput improves could spur significant revenue and cash flow growth in the consumer segment, albeit toward the end of the year.

5G should gain momentum but it’s not a game changer yet

5G is generally seen as the next big growth area for telecom providers. Early adopters such as South Korea, China, and Japan have seen a moderate 1% monthly increase in 5G penetration since they launched in 2019, but with only modest gains in overall average revenue per user (ARPU). While many other markets, including the U.S., have deployed 5G services, adoption remains lackluster and wireless spectrum deployment strategies vary for each carrier impacting availability. However, as more 5G spectrum—in particular mid-band spectrum (which was delayed in many markets owing to the pandemic)—is deployed and more technologically advanced 5G handsets are made available in a recovering economy, we believe consumer adoption of 5G wireless services could gain momentum, likely by mid- to late-2021 and thereafter.

We remain less enthusiastic on the prospect of material revenue growth from 5G from the consumer segment given relatively good performance characteristics of mature 4G/4.5G networks and limited appeal for consumers to pay a premium for 5G in the current economic environment. Meanwhile, the industry’s quest to monetize low latency and superior throughput characteristics of 5G continues, and we are seeing more partnerships, business models, and trials in this area. Verizon in the U.S. is already using the moniker “Network As a Service” as it establishes itself as a player in the internet of things (IoT) and edge computing, targeting large white space(s) in the commercial, industrial, and government end-markets. Similarly, in South Korea and Japan we are seeing early success in consumer-oriented gaming and virtual/augmented reality (VR/AR) applications. Nonetheless, while we acknowledge 5G’s long-term opportunity, we do not believe it will be a significant revenue source any time soon because commercially ready 5G use cases remain elusive and distant.
High telco capex precludes deleveraging any time soon

We expect telecom capex to remain high in 2021 to support 5G roll-outs as well as fiber-to-the home (FTTH) in converged markets. Higher capex to some extent also reflects pandemic-led deferrals and reprioritization of initiatives; for example, spending to support the unanticipated fixed-broadband surge. While major fiber deployments will likely tail off within the next few years, we expect 5G densification and information technology (IT) spending will limit a substantial drop in spending. More notably, we expect increased spending for 5G wireless spectrum in 2021 (principally for 3.5 GHz spectrum) and future years as more mid-band and high- to ultra-high-band spectrum becomes available. In contrast, cable industry capital intensity should ease, given its ability to incrementally scale networks and lower costs by migrating to self-install(s) and lower priced nonproprietary equipment. Meanwhile, pandemic-accelerated digital transformations should help all providers lower the cost to service and acquire customers.

High capex combined with shareholder payouts likely constrain discretionary free cash flow available for debt repayment for telecom providers. Telcos worldwide are considering alternate means to fund their capital calls such as network and spectrum sharing (some of which is arguably regulatory driven), monetizing tower and fiber networks as well as the sale of noncore legacy, lower-scaled telecom operations and media assets. Furthermore, government support to bridge the digital divide and support rural and remote broadband connectivity could allow servicing these areas to be more economically tenable for some providers. While we have a positive view of such efforts to review strategy, capital allocation, and asset mix to mitigate rising financial risks and improve financial flexibility, tight leverage headroom will remain a key ratings risk because the net benefit from such actions are limited from a credit perspective.

Nonetheless, we acknowledge that in a low-interest-rate environment, a telco’s ability to access low-cost debt to fund long-lead assets has less impact on coverage ratios and free cash flow than in prior years. Though cable companies will likely continue to generate strong free cash flow, we assume most of it will be returned to shareholders.

Key risks or opportunities around the baseline

1. A recession in 2021 can put more pressure on credit metrics

   Given that promising vaccines appear to be on the horizon, a weaker recovery from the health crisis due to ongoing shutdowns or other unknown variables, such as vaccine distribution and adoption, could impair revenue growth and cash flow generation.

2. Regulatory implications are mixed

   While pro-competitive mandates are unlikely to change in the next few years, lessons from the pandemic have the potential to shift policies.

3. Fixed-broadband and 5G drives upgrades

   Increasing adoption of work-from-home arrangements increase the demand for fast fixed broadband service while 5G use cases and revenue opportunities are likely a few years away.

A prolonged recession in 2021 could impair credit quality

Our base case assumes a widely available COVID-19 vaccine by mid-year 2021, which should improve mobility and propel global economic output of about 5%. Vaccine availability, distribution, and, more importantly, its field effectiveness and adoption
remain unknown variables. With lower customer activity in 2020 and 5G delays already constraining growth in 2021, a weaker recovery from the health crisis or an economic retrenchment as government stimulus ease could hamper subscriptions and recurring service revenue growth even more. High promotional activity and an acceleration in cord cutting by consumers, combined with curtailed spending by business customers (particularly SMBs) under this scenario, could have a bigger negative impact on the industry's cash flow, in our opinion. The compounding effect of a two- to three-year economic contraction against less discretionary capital outlays (such as spectrum and dividends) could eliminate leverage headroom for many issuers, escalating the risk of negative rating actions.

**Regulatory risks are mixed across markets**

Pro-consumer regulatory policies have helped shape the competitive dynamics in most jurisdictions over the past decade and have been a factor in our downgrades in recent years. Lower tariffs, network sharing, spectrum set-asides and caps, and other support for new entrants to spur competition as well as a limited appetite for consolidation have hindered incumbents from achieving greater returns on their investments. Indeed, return on capital across our rated telecom universe has generally been declining the past several years. Also, the pandemic has forced governments to accelerate programs that support low-income households and broaden affordable broadband availability to rural and remote communities. While pro-competitive mandates are unlikely to change any time soon, we believe pandemic-related lessons have the potential to slightly shift policies to accommodate sustained network investment to support network resilience and greater broadband access. And, the regulatory appetite for M&A could also ease somewhat. Nonetheless, we acknowledge that a good read on regulatory direction is a challenge and could prove aspirational. For example, a new administration in the U.S. could reverse the current policies on net neutrality as well as swing the anti-trust bias against large M&A. Longer-term legislation around broadband regulation is unlikely due to the potential for gridlock in Congress.

**5G and fixed broadband support industry growth**

Stay and work-at-home directives and social distancing is shining a light on broadband’s importance to the modern economy. As noted earlier, we expect adoption and usage of fixed-broadband services to remain strong as businesses embrace the benefits of remote work, and as consumer consumption of streaming services, e-commerce, e-learning, gaming, and social video use increases. Any positive change of consumers' value perception toward broadband bodes well for providers that have invested in their networks, although benefits will likely be limited to jurisdictions with more balanced regulation.

5G wireless represents another area of significant long-term growth for the industry. We assume consumer 5G adoption will gain some momentum in 2021 and accelerate through 2023 as speeds and coverage improve. While early markets such as South Korea are seeing a lift in ARPU from 5G due to the upselling to larger and faster data speed propositions, we do not assume this is sustainable given limited potential for differentiation as rivals catch up. The real opportunities for 5G lie in leveraging its low-latency and high-speed capability, which will only emerge as carriers deploy ultra-wide band millimeter wave (mmWave) spectrum, build-out fiber for backhaul, and densify their networks. The carriers will also need to be supported by industry and institutional participation in developing commercially viable use cases. As such, we expect monetizable use cases to exploit 5G will take time to evolve and will require additional investment, but could ultimately provide a new, and potentially substantial, source of sustainable cash flow for the industry.
Main assumptions about 2021 and beyond

1. High speed internet will become more embedded in the lives of consumers
COVID-19 has created a structural shift in how people work, which has increased demand for faster data speeds at home while the proliferation of streaming services has resulted in more people using broadband connections for consumer content.

2. Divergent capex trends for telecom and cable
The buildout of newly acquired spectrum licenses and deployment of fiber should contribute to higher levels of capex for the U.S. telcos while cable capex should be relatively stable, although wireless network investments is the biggest unknown.

3. New 5G devices could result in more near-term wireless competition, and longer-term industry trends are clouded by new entrants
The launch of the iPhone 12 and new promotions by carriers could result in higher churn and some margin compression in the next 12 months or so, because we expect upgrades to increase. While the merger between T-Mobile and Sprint, and resultant shift to three nationwide wireless operators from four, should benefit competitive intensity, new entrants make for a murkier competitive environment.

Spectrum purchases and higher capex could cause telco credit metrics to weaken, while cable should remain stable
Overall, we expect modest low-single-digit percentage service revenue growth in U.S. wireless, mid-single-digit percentage declines in wireline, and solid mid-single-digit revenue growth in cable in the coming year, although our forecast depends on the recession’s severity and length.

For the U.S. wireless segment, we expect improving postpaid subscriber and service revenue growth on the back of an improving economy in 2021. However, the launch of new 5G handsets could drive more aggressive promotional activity as carriers will look to differentiate their networks, resulting in higher churn and upgrade rates and some margin compression. At the same time, we do not expect consumers will be willing to pay more for faster 5G data speeds on their devices since expenditures for wireless services in the U.S. are already high. As such, 5G mobile offerings may not translate into significant ARPU or top-line growth. Similar dynamics are at play in Canada, as evidenced by significant wireless promotions in the third quarter of 2020 as the economy opened. Also, with the industry transitioning to bigger data buckets and an equipment financing model (from a subsidized handset and contract approach), we don’t anticipate any improvement in average billing per unit until late 2021. For the U.S. wireline segment, secular industry pressures, competition from cable, and economic pressures on SMB customers will continue to affect top-line performance while higher capex for fiber deployments will likely result in higher leverage and reduced free cash flow generation.

We believe broadband revenue and contributions from commercial services in U.S. cable will outpace video subscriber declines. Greater contributions from broadband and lower revenue from video should also enable modest margin expansion for the cable providers, though wireless startup costs will likely constrain significant improvement.

We expect credit metrics for U.S. telecom operators will weaken in 2021 on the back of spectrum purchases in the C-band auction and higher levels of capex to support 5G network upgrades and fiber deployments. Conversely, we expect credit quality for U.S. telecom operators to weaken in 2021 on the back of spectrum purchases in the C-band auction and higher levels of capex to support 5G network upgrades and fiber deployments.
cable operators to remain stable. Growth from broadband services will more than offset declines in video customers and wireless startup costs, resulting in margin expansion and EBITDA growth. However, the pressure to return money to shareholders will likely constrain any significant credit quality improvement.

For the C-band wireless spectrum auction, we expect proceeds to be anywhere from $23 billion to $41 billion based on a valuation of $0.25 to $0.45 per megahertz (MHz) per person (POP) (see table 2). With 280 MHz of contiguous spectrum and good coverage characteristics, we expect the wireless carriers, along with DISH and the cable providers, to be particularly aggressive in this auction and proceed could approach the $45 billion achieved in the advanced wireless services (AWS)-3 auction in 2015. We expect Verizon to be the most aggressive given its weaker spectrum position and its push to reduce leverage over the past couple of years to give it greater financial capacity to acquire new licenses (see chart 7). Though T-Mobile has sufficient mid-band spectrum from its acquisition of Sprint, it could acquire more licenses in the C-band auction to maintain its competitive advantage. At the same time, while AT&T’s balance sheet is somewhat constrained from recent M&A, it could use proceeds from the sale of noncore assets to give it greater flexibility to participate in the auction. We also expect the cable providers to acquire spectrum in certain regions while DISH could be an aggressive bidder as well, despite its limited balance sheet capacity and upcoming network spending.

Table 2
Recent U.S. spectrum auctions

<table>
<thead>
<tr>
<th>Timeline</th>
<th>Spectrum Band</th>
<th>MHz</th>
<th>Valuation</th>
<th>Estimated Gross Proceeds (US$ mm)</th>
<th>Actual Proceeds (US$ mm)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Low</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td>Nov. 14, 2018</td>
<td>28 GHz</td>
<td>850</td>
<td>$0.005</td>
<td>$0.030</td>
<td>315</td>
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<tr>
<td>April 17, 2019</td>
<td>24 GHz</td>
<td>700</td>
<td>$0.005</td>
<td>$0.030</td>
<td>1,092</td>
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<tr>
<td>Feb. 6, 2020</td>
<td>37, 39, 47 GHz</td>
<td>3400</td>
<td>$0.006</td>
<td>$0.010</td>
<td>6,365</td>
</tr>
<tr>
<td>July 2020</td>
<td>3.5 GHz (CBRS)</td>
<td>70</td>
<td>$0.100</td>
<td>$0.300</td>
<td>2,205</td>
</tr>
<tr>
<td>Dec. 2020</td>
<td>3.7-4.2 GHz (C-Band)</td>
<td>280</td>
<td>$0.250</td>
<td>$0.450</td>
<td>22,750</td>
</tr>
</tbody>
</table>

Chart 7
U.S. wireless industry spectrum license holdings (excl. mmWave)

In Canada, the 3.5 GHz spectrum auction was pushed to mid-2021 to incorporate the ruling on mobile virtual network operators (MVNOs) as well as allow carriers to focus on supporting their broadband operations and customers through the pandemic. Given the attractiveness of 3.5 GHz for early-5G deployments, we anticipate the auction will be well contested amongst the Big-3 incumbents given limited availability (owing to new entrant...
set-asides) and its attractive throughput characteristics. Even though the effects of an adverse MVNO ruling may be marginal at first, the combination of the 3.5 GHz and mmWave spectrum auctions, C-band in the near future and ongoing shareholder distributions would continue to keep the Big-3 telco’s credit metrics elevated for the foreseeable future.

**Divergent capex trends for telecom and cable**

The U.S. Federal Communications Commission (FCC) has completed several spectrum auctions for mmWave licenses and mid-band spectrum (citizens broadband radio service CBRS). Furthermore, the long-awaited C-Band auction should contribute to higher levels of telco capital spending over the next few years.

We expect U.S. telco capital spending to increase around 3%-5% in 2021 as new mid-band spectrum is made available (C-band and CBRS) and companies upgrade their networks to accommodate the growing demand for mobile data and video (see chart 8). These capital outlays will also include expenditures for wireless backhaul and fiber broadband. For the wireline segment, ongoing fiber deployments should also contribute to higher capex. Following the reduction of its dividend in 2019, CenturyLink increased its capital spending by around $500 million. As Windstream and Frontier exit bankruptcy, we expect them to take advantage of lower debt burdens to invest in FTTH broadband connections to better compete with cable. Similarly, with the recent refinancing of its capital structure, Consolidated Communications also received an equity investment from private equity sponsor Searchlight Capital.

**Chart 8**

**U.S. telco capital expenditures**

We expect U.S. cable capex to remain relatively flat for the next several years, with wireless network investments being the biggest unknown. The largest component of capex (30%-40%) is customer premise equipment, which will keep declining as the number of video customers continues to shrink. We expect that scalable infrastructure (20%-30%), such as head-end equipment, could be choppy depending on the timing of the next data-over-cable service interface specifications (DOCSIS) upgrade cycle. Line extensions and upgrades (20%-30%) should be relatively flat as operators drive fiber deeper into the networks and split nodes, which will be offset by more software-defined network solutions, which are cheaper to maintain. However, nascent mobile operations require more retail stores and likely network buildouts in select markets to offload traffic, which will likely offset declining core cable capex trends, keeping capex-to-revenue around 14%-15%.
In Canada, 2021 capital spending will be higher compared to this year because some investment was deferred amid the pandemic closures when there were fewer customer loadings. We also expect increased 5G-related network spending as operators deploy new spectrum and technologies. With most of the fiber capital behind, increasing self-installs and lower costs could offset some capital increases. But with upcoming spectrum auctions and its deployment for 5G, we anticipate capex to increase in 2021 and 2022.

New 5G devices could result in increased wireless competition, and longer-term trends are clouded by new entrants.

Despite recent wireless industry consolidation, the launch of the new 5G-enabled iPhone 12 and the desire to differentiate their 5G wireless networks, could result in aggressive promotional activity, greater price-based competition, and higher churn over the next year or so.

While longer-term trends should benefit from recent consolidation, the industry outlook is clouded by the sale of Sprint’s prepaid business and spectrum-to-satellite TV operator DISH Network Corp., which plans to use its own spectrum to build out a nationwide network. At the same time, incumbent cable providers Comcast, Charter, and Altice have launched their own wireless operations through MVNO agreements. That said, while competition from cable could ramp up over the next couple of years, the low margin profile of MVNO agreements in a very scale-intensive industry suggests the impact on the wireless operators will be marginal at best and that cable providers will likely struggle to gain traction in the marketplace. Furthermore, we think DISH’s ability to become a viable fourth nationwide wireless carrier in the U.S. is still highly uncertain. The company has a small prepaid customer base of around 9 million acquired by Sprint and a seven-year MVNO agreement with T-Mobile that will constrain cash flow generation for the next several quarters. We also believe DISH’s lack of experience in wireless could make it challenging to compete. Given these factors, we expect DISH’s primary objective will be to capitalize on the proliferation of connected devices and new IoT opportunities likely to emerge with 5G technology, with limited exposure to traditional consumer wireless.

Key risks or opportunities around the baseline

1. Increased regulation

Although unlikely any time soon, the biggest long-term risk for U.S. cable operators remains pricing regulation. There are also some opportunities for increased funding for broadband if Democrats can control the Senate, which will not be known until January.

2. The coronavirus pandemic and recession could hurt financial performance

While broadband services should continue to perform well, a prolonged recession could weigh on revenue from wireless services, video, SMB, and larger enterprise customers.

3. The impact of 5G on wireless and cable is uncertain

Investments from 5G could hurt credit metrics for the wireless carriers while revenue opportunities may take time to develop. At the same time, the 5G-fixed wireless could make it more difficult for cable providers to monetize increasing demand for broadband services.

Increased regulation

We believe the increased importance of high-speed internet coupled with rising broadband prices means cable operators could come under increased regulatory
scrutiny. However, the implementation and enforcement of government-mandated price caps remains a low probability over the next two years because penetration rates do not yet support monopolistic market conditions.

We believe a top priority of a Democratic FCC will be to reinstate cable providers as Title II “common carriers” under the 1996 Communications Act to enforce no blocking, no throttling, and no paid prioritization of internet traffic. This reclassification also provides latitude for the FCC to enforce pricing regulation but it will be time-consuming to draft an order, it will likely be appealed, and a future administration can go back to the more lightly regulated Title I “information services” classification. A more permanent threat would involve Congress passing a law enforcing net neutrality that also included a framework for pricing oversight and regulation. However, Democrats would need to win both January 2021 run-off Senate elections in Georgia for this to be possible and even then, it is unclear where broadband regulation would rank in Congressional priorities.

We believe a Democratic-controlled Senate could bring broadband availability and affordability into greater focus. This could provide an opportunity for cable and telecom providers to apply for more grants to expand service into markets that cannot justify adequate stand-alone returns. Conversely, this could provide a threat to the incumbent phone company in underserved markets. However, if Republicans retain control of the Senate, it is unlikely that the massive infrastructure bill called the Moving Forward Act (which includes $100 billion in incremental broadband funding) will pass.

In Canada, steps taken by the telecom regulator through the pandemic have led to more constructive relationships between the lawmakers and the carriers, in our view. Nevertheless, we expect the Canadian Radio-Television and Telecommunications Commission (CRTC) will continue to focus on increasing competition in the Canadian telecom space. The final rates proposed by the CRTC on wholesale internet access services or third-party internet services (TPIA) were significantly lower and are currently under appeal. We also expect the CRTC to rule on wholesale MVNO access. The most likely outcome, in our view, is that it opens up the existing infrastructure network to established regional operators in Canada such as Shaw Communications Inc., Videotron Ltee (a subsidiary of Quebecor Media Inc.), Cogeco Cable, and Eastlink Inc., rather than opening access to new players.

The pandemic and recession could hurt financial performance

While U.S. telecom and cable has held up reasonably well during the coronavirus pandemic and resultant recession, an extended economic downturn in 2021 could have a greater impact on operating and financial results. In wireless, mobile devices have become a necessity for most people and consumers are unlikely to rid themselves of wireless services. That said, if the pandemic causes an extended economic recession, much of the postpaid subscriber growth over the past couple of years could reverse. Consumers could look to save money by moving to lower-margin prepaid plans or less-expensive postpaid plans, which could affect subscriber and service revenue trends. At the same time, business customers may reduce headcount to preserve margins, which could hurt subscriber trends since a large portion of postpaid customer growth has come from the proliferation of second handsets as companies distribute smartphones and tablets to their employees for work. A partial mitigating factor is the potential for a more permanent work-from-home environment where mobile devices become more critical and increase demand for wireless data.

In contrast, we expect more of an impact on wireline companies with exposure to business customers. While revenue from SMB customers has held up well since the beginning of the pandemic because of government stimulus, revenue from this segment could come under pressure in 2021 from a prolonged economic downturn as SMB customers scale back operations or go out of business altogether. At the same time,
larger enterprise customers could cut IT spending or shift to less expensive cloud-based networking technologies.

Cable operators are capitalizing on demand for faster, more reliable internet service. While the rate of subscriber growth may decelerate next year, we believe long-term industry trends favor cable and expect high-speed data (HSD) penetration to continue to rise. Even in a recessionary environment, we believe churn is unlikely to accelerate as the internet is one of the last services consumers will drop. Therefore, we are projecting mid-single-digit EBITDA growth in 2021, despite the potential for SMB revenue declines in a second wave of business closures.

The impact of 5G on wireless and cable is uncertain

U.S. wireless carriers are at work deploying 5G networks across the country. Already T-Mobile is using its 600 MHz spectrum and now covers about 270 million POPs with 5G service. AT&T is also using its low-band spectrum and covers around 205 million POPs. That said, spectrum deployment strategies differ, which effects user experience and download speeds. For example, while T-Mobile has greater 5G coverage, its use of low-band spectrum diminishes performance, in our view. However, with the acquisition of Sprint and the purchase of some mmWave spectrum, the company will create a “layer cake” that we expect will enhance coverage and speed. Verizon, in contrast, is using its vast quantity of mmWave spectrum to provide superior speeds in denser urban markets. However, mmWave spectrum lacks good coverage, thereby limiting Verizon’s deployment to urban centers.

We believe that cash outlays for 5G will likely be substantial, including the acquisition of spectrum licenses in mid-band auctions and higher capital spending to build out these networks, including fiber builds and small cell densification.

At the same time, we believe returns on these investments will be slow to materialize. We question consumers’ propensity to spend more for faster data speeds on their devices. The depth of the recession creates even more uncertainty around take rates for new 5G devices. Most of the IoT and enterprise opportunities are likely several years away. While 5G fixed wireless offers some potential to monetize investments at an early stage, the technology is still unproven and it will be challenging to take share from cable broadband, which can already provide 1 gig service to its customers without line-of-sight or interference issues.

We do not expect new 5G fixed wireless competition to hurt cable earnings in 2021 since buildouts from Verizon and T-Mobile are in the early stages. Still, we believe new wireless competition could hinder cable’s ability to raise broadband pricing and continue to expand profit margins over several years. While cable will continue to have the speed and reliability advantage, the potential for aggressive pricing exists from new competition given cheaper last-mile costs, particularly as wireless operators aim to subsidize necessary investments to support 5G mobile. However, it is unclear whether a wireless network can handle significant penetration of in-home internet, given exponentially rising data usage.
Main assumptions about 2021 and beyond

1. European operators have mostly weathered the pandemic fallout

European operators demonstrated relatively stable performance despite COVID-related headwinds with virtualization driving increased reliance on telecom services. We expect modest declines in revenue and earnings will reverse with the recovery.

2. Capex is likely to remain high

We believe average capex intensity will remain elevated, at close to 19% of revenue. A focus on fiber rollouts and gradual pick-up in 5G spending will drive the investment in many markets, with broadband upgrades a renewed objective after the ramp up in usage resulting from the pandemic.

3. Fixed-network assets may join the wave of mobile tower sales

We think a growing number of operators will consider fixed-network sales. This continues the trend of monetizing tower assets and can also push some of their fiber investment costs off the balance sheet. This could improve financial flexibility in the absence of material growth.

European operators have mostly weathered the pandemic fallout

While we took negative actions (outlooks and downgrades combined) on about 12% of the broader EMEA telco portfolio due in part to the pandemic, half of the actions were driven by sovereign rating actions (South Africa, Nigeria, and Bahrain), and COVID-19 operational fallout only contributed to one downgrade in Europe (Telefonica). Similar to other markets, telecom operations have been supported by heavy network utilization as work, education, and leisure have increasingly gone virtual, relying on telecom connectivity. We expect stable ratings for the vast majority of issuers in Europe.

The biggest revenue headwinds during the pandemic have come from low-margin equipment sales, and the largest effects on earnings are from lower roaming, pre-paid, and business to business (B2B) spending. Telcos with outsized mobility and media exposure have also suffered. This includes satellite companies providing remote broadband connectivity, as well as more traditional operators like Telia, Altice and BT, with the former’s Bonnier broadcaster acquisition hit by weak advertising, and the latter two unable to fully monetize high sports-rights costs.

Although competition remains intense in many markets, credit metrics should see some improvements from 2021 through a rebound in mobile, the gradual benefit of accretive fixed line broadband upgrades, and continued cost-saving efforts (see chart 9). In some cases additional support may come from inorganic leverage-reduction measures such as disposals. Proximus recently announced the sale of its international carrier business, as has Telia, along with its stake in Turkcell. Telecom Italia announced sales of a minority interest in its secondary copper and fiber network and a majority stake in its tower business, as have several other operators, and we expect more to come.
Modest rebound for telcos and cablecos in 2021

We expect cable companies to display slightly better revenue and EBITDA growth than telcos, albeit also accompanied by high capex intensity. However, capex intensity should moderate after 2021 as larger network upgrades (including DOCSIS 3.1) approach completion. We think solid cash flow generation will provide cable companies with greater organic deleveraging capacity than telcos, outside of an elective footprint expansion and fiber overbuilds.

Capex is likely to remain high

Capex is likely to dip from our initial forecast in 2020, slowed by COVID-related work disruptions (see chart 10). Catch-up investment should be faster with fiber. This can be partly absorbed by a pullback in mobile spending after 5G spectrum and handset delays, low short-term commercial prospects for the new technology, and postponed equipment procurement due to Huawei uncertainty. Compared to North America and APAC, we therefore expect higher fiber spending and lower 5G spending, though we forecast a gradual ramp-up in 5G spending and that elevated levels will be maintained in 2021 and beyond.
Indeed, COVID has highlighted the importance of high-speed broadband in keeping economies functioning despite mobility restrictions. As a result, heavy fiber spending over the next two to three years reflects the renewed priority of network upgrade plans. This will be particularly pronounced in markets like the U.K. and Germany, which have lagged on fiber deployment, and where demand from both consumers and governments should reprioritize high-speed broadband development.

While fiber rollout may increase customer upgrade prospects, it hasn’t been to the same degree as in the U.S. market. We therefore see short-term pressure on cash flow and deleveraging prospects. While weaker revenue is being partly offset by slower 5G spending in 2020, we think accelerated fiber and a gradual catch-up in 5G capex will constrain free operating cash flow through 2021, until growth is restored.

Fixed-network assets may join the wave of mobile tower sales

With high capex and average adjusted debt to EBITDA expected to rise in 2020 toward the weak end of rating bands, stubbornly low-growth prospects, and weak stock performance, we see some operators looking for ways to capitalize on the higher value of their infrastructure assets (see chart 11).

European operators have been selling off tower assets to help meet these challenges. We expect this will continue, with large transactions recently announced by Vodafone and Hutchinson. Increasingly, we think fixed-line infrastructure, and fiber in particular, will join this trend.

Telcos can gain balance sheet flexibility from the sale proceeds of mature assets if the valuation multiple is high enough. For less mature assets, it can introduce new owners to share the cost of additional investment, or take it off the balance sheet altogether. Offloading capex can be especially compelling for telcos early in the fiber investment cycle, or that are looking to extend coverage to less dense areas that have high connection costs per household.

The challenge is that early stage assets carry investment and commercial risk that may impair valuations. And selling off more mature assets with higher valuations could weaken the business profile of telecoms if they lose control of strategic and differentiating networks. We therefore expect to see more partial sales, similar to what Altice has done with its French fiber, Telecom Italia is doing with its secondary network, and Telefonica has historically done with its tower assets via Telxius.
Key risks or opportunities around the baseline

1. A prolonged recession could delay recovery

If mobility remains depressed beyond Q2 2021, mobile revenues may fail to rebound. If combined with weak broadband upgrades, growth could remain negative in 2021.

2. Competition could resurge

After reduced churn rates during the pandemic, price competition could flare up again. Low-price value challengers in competitive markets may have incentive to aggressively grow market share if high unemployment and low consumer spending increase demand elasticity.

3. More supportive regulation could improve competitive conditions

Greater reliance on telecom services during the pandemic has raised the strategic stock of communications infrastructure. This could prompt a more accommodative regulatory stance on fiber, spectrum pricing, and competition to encourage investment.

A prolonged recession could delay recovery

Our forecast for improved mobile revenue could face challenges if the recession continues deeper into 2021, especially if COVID concerns delay a return to more normal mobility. While fixed broadband should continue to perform well, mobile roaming revenue would be exposed to less intense usage outside the home, affecting consumer and business spending decisions. A slower return to normality could also keep international travel volumes depressed for longer. This predominantly hurts operators with a net influx of roaming customers on their networks, such as those of southern Europe.

We also see risk of an extended recession in the B2B segment. SMEs without the same financial and technology resources as bigger companies will be unable to maintain full operations remotely, even with support from fiscal stimulus. And large enterprises could further delay or cancel telecommunications spending as belt-tightening measures.

Competition could resurge

Most European telecom markets remain highly competitive, with up to four converged operators in countries like France and Spain. Meanwhile, aggressive value segment challengers have been disruptive in other markets like Italy (Iliad) and the U.K. (TalkTalk).

Competition has somewhat calmed during the pandemic as a result of mobility restrictions. This has reduced gross additions from the in-store channel, as well as the availability of customer premises equipment and household visits for installation. Promotional activity has also declined in tandem.

However, this could reverse as restrictions ease. High unemployment and reduced discretionary spending may also leave consumers and businesses looking to economize. This could hit mobile harder than fixed if post-COVID mobility patterns prove resilient longer term. It may also impact more competitive markets like Spain, Italy, France, or the U.K., or those suffering deeper macroeconomic conditions. With greater consumer elasticity, challengers may try to peel away price-conscious customers from their peers with new offers. If reciprocated, retaliation could lead to falling prices and revenue.
More supportive regulation could improve competitive conditions

We think improved regulation could be catalyzed by the pandemic, which has enhanced the strategic profile of telecom infrastructure in the eyes of many stakeholders. As governments have urged reduced mobility to combat the spread of the virus, virtualization has enabled parts of the economy to avoid a more severe downturn. Broadband has kept numerous businesses running and remote workers employed, and has expanded the online sales channel for many brick-and-mortar businesses.

But operators continue to struggle with weak growth prospects and uncertain returns on capex. Given the societal benefits, government and regulators may reprioritize advanced telecom networks as a more strategic objective than before, and therefore be willing to pursue frameworks that encourage investment. Regulation that gives better visibility and confidence in an economic return could support such goals.

Tolerance for M&A is also likely to be retested after the EU General Court overturned the European Commission's 2016 decision to block consolidation in the U.K. While still out on appeal, a move toward in-market consolidation could drive long-term benefits to market structure and create a more sustainable competitive environment for European operators.
Latin America

Main assumptions about 2021 and beyond

1. Telcom is well positioned to recover in 2021

Revenue rebound amid foreign exchange (FX) stabilization should help return debt leverage to pre-COVID levels in 2021.

2. Modest capex growth

Disciplined capex increases targeted to scale 4G capacity and prepare terrestrial-networks for 5G.

3. Financial discipline before shareholder returns

Latin American telcos will likely limit shareholder returns and focus on sustaining liquidity and build financial flexibility.

LatAm telcos are well positioned to recover in 2021

We anticipated a difficult 2020 for the region’s telco sector due to headwinds on economic growth. While the pandemic exacerbated such downside risks, increasing needs for remote connectivity and streaming entertainment drove demand for broadband and wireless services, particularly after the first quarter of the year. With most of the important currencies depreciating to the dollar, and ARPU suffering from postpaid and prepaid discounts during the pandemic, for 2020 we only expect a single-digit top-line contraction in dollar terms. We believe credit metrics will return to pre-COVID levels in 2021, not only due to resilient and increasing data usage, prepaid customer conversion, and to the expansion of 4G-4.5G coverage, but also as a widely available vaccine helps address health risks in key markets.

Modest growth in capital investments

Following a year where companies across the sector privileged liquidity to mitigate short-term risks related to the pandemic, we expect a cautious uptick in capex allocations next year that would represent between 18% and 19% of revenues (see chart 12). With no clear rules for 5G deployments in some markets, and companies still enhancing 4G networks, we generally don’t anticipate significant 5G investments during the next few years. Instead, we expect companies to continue focusing on the expansion of fiber, 4.5G technology, and network virtualization. Capital investments could also be directed to the pursuit of M&A.

Financial discipline before shareholder returns

While dividend distributions and share repurchases showed an upward trend pre-COVID, we expect leverage and liquidity to drive financial management. Regardless of the rating level, companies across the region will continue to work to reduce debt in 2021. Several also made some adjustments to their dividend and share repurchase plans, and shareholder returns for next year will only depend on financial performance. We also expect active liability management, with companies taking advantage of low interest rates, and looking to extend their debt maturities (see chart 13). Some issuers are also trying to reduce their exposure to foreign currency debt to mitigate potential exchange-rate fluctuations. Sovereign ceilings or parent company rating caps could weigh on a few IG players.
Key risks or opportunities around the baseline

1. Sovereign or parent linkages are an area of credit risk
Sovereign ceilings or parent company rating caps could weigh on a few IG names.

2. FX risk could weigh more than COVID-19 risk
Further depreciation of local currencies versus the U.S. dollar is a headwind to leverage improvement.

3. Recovery shape adds some uncertainty
Weak macroeconomic conditions or a recession could trigger ARPU pressure from downward migrations.

Sovereign ratings or parent support could be a drag on credit quality
Latin American IG issuers have remained largely resilient to the pandemic, and we have seldom identified pressure points that could trigger negative rating actions on a stand-alone basis. However, some IG issuers facing a sovereign cap or constrained by a parent company are at risk if the related higher-level entity suffers a downgrade. In the case of Argentina, credit quality for the sector is currently hampered by tighter central bank regulations on accessing foreign exchange. We've also identified large global players with a presence in Latin America, seeking to divest certain operations, which could point to lower commitment of extraordinary support.

FX risk could weigh more than COVID-19 risk
The performance of telecom operators has remained resilient in local currency terms, as 2020 revenues will likely reach mid-single-digit growth. However, the depreciation of most currencies in the region to the dollar will likely result in a double-digit revenue contraction in dollar terms that will weigh on key credit metrics, particularly on leverage. If high exchange rate volatility persists in 2021, companies exposed to foreign currency debt could see further deterioration of credit metrics and ratings would likely come under pressure.
The shape of recovery remains uncertain

A weaker-than-expected performance of mobile ARPUs remains a threat to the sector. We believe there is a realistic risk that lower disposable income and high unemployment may affect consumer preferences, and that we could eventually see higher migration to low-cost plans or a decline in prepaid recharges. In addition, we expect a temporary (and in many cases permanent) closure of SMBs in the B2B segment, because such customers had a limited ability to absorb the business interruption during the lockdown. We also expect a hit to equipment sales and some transitional impacts in terms of collections, though no material increase in credit losses.
Asia Pacific

Main assumptions about 2021 and beyond

<table>
<thead>
<tr>
<th>1. COVID-19 has a limited impact on APAC telcos</th>
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<tbody>
<tr>
<td>The telecom sector’s low cyclicality and utility-like demand characteristics should result in the pandemic having limited impact on APAC telcos’ earnings over the next year or two. Although movement restrictions and deteriorating purchasing power could result in lower roaming, pre-paid wireless, and B2B revenue for certain operators, increased demand for data due to work-from-home and remote learning should help moderate the impact.</td>
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<tr>
<th>2. Capex should remain elevated due to investment needs for advanced networks such as 5G</th>
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<tbody>
<tr>
<td>We expect capex to remain high next year amid continued 5G deployment and network upgrades, as well as spectrum spending. Continued large capital investments are likely for 5G networks on Korea, China, Japan, and Australia.</td>
</tr>
</tbody>
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<tr>
<th>3. M&amp;A is likely to continue</th>
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<tbody>
<tr>
<td>We expect ongoing M&amp;A in APAC as telcos seek economies of scale, competitive service offering, and cost synergies from combined resources given saturated telecom markets and sizable investment needs for advanced networks.</td>
</tr>
</tbody>
</table>

COVID-19 and economic recession will have limited impact on APAC telcos' earnings

We believe the pandemic and the resultant economic recession will have a limited impact on the sector’s earnings over this year and next. The telecom sector’s low cyclicality and utility-like demand characteristics limits the correlation with macroeconomic conditions, making the pandemic’s impact on earnings more manageable than that on other sectors.

Furthermore, increasing data usage due to work-from-home, remote learning, and increased online content consumption should also help moderate the impact of lower roaming revenues owing to travel restrictions imposed to contain the pandemic.

That said, some operators in APAC may witness pressure as a weaker economic environment and deteriorating purchasing power may result in smaller pre-paid recharges and delays in their B2B business contracts adding to their existing woes of intense competition in their respective markets.

Overall, under our base case, we forecast a flattish to slight decline in earnings for APAC telcos in 2020 before posting a modest recovery next year (see chart 14).

Capex will remain elevated due to investment needs for advanced networks

We expect capex to remain elevated in 2020 and 2021, amid the deployment of advanced networks such as 5G (see chart 15). In our view, high capital investments for 5G networks are likely to continue in developed APAC markets such as Korea, China, Australia, Japan, Taiwan, and Hong Kong, who continue to expand their 5G deployment. That said, we believe telcos in said regions will exercise discipline and take a more measured approach in their investment plans given advanced use cases of 5G technology are still some years away.
We also believe some telcos may opt for co-building and co-sharing of networks to lessen their investment burden. We expect telcos in developing markets such as Thailand, Philippines, and Indonesia, to increase their capex due to continued investment in 4G LTE networks, and for acquiring 5G spectrum.

Chart 14
APAC telcos’ debt-to-EBITDA modestly weakens

Chart 15
APAC telcos’ capex remain elevated

M&A is likely to continue

We expect ongoing M&A in APAC as operators continue to pursue cost synergies, economies of scale, and 5G readiness through media-telecom convergence and industry consolidation.

In Korea, for instance, KT Corp., through its affiliate KT Skylife Co. Ltd., plans to acquire Hyundai HCN Co.’s cable TV business. KT corp. has also participated in the bidding for another cable TV operator, D’Live. These developments follow similar such media-telecom convergence deals by its competitors (SK Telecom Co. Ltd. and LG Uplus Corp.) in recent years to strengthen their pay-TV market position in the country.

In Japan, incumbent operator NTT has turned its listed mobile communications subsidiary, NTT Docomo, into a wholly owned unit through a ¥4.3 trillion (about US$43 billion) tender offer completed in November 2020. We believe the takeover will have negative implications for NTT and its group companies as NTT plans to finance the acquisition mostly with debt. This transaction may benefit NTT’s performance and operations to some extent because it would help optimize group resources and create room to reduce costs further, but negative impacts on financial metrics will far outweigh the benefits to its business, in our view.

In Australia, the recent merger of TPG Telecom Ltd. and Vodafone Hutchison Australia Pty Ltd. should ease competitive pressure to some extent and help the merged entity realize scale benefits and synergies from the combined resources to deal with the competition and prepare for 5G rollout.
Key risks or opportunities around the baseline

1. Initial 5G uptake is promising, but new use cases remain distant

Initial consumer 5G uptakes in markets such as Korea and China are showing encouraging trends. We believe better 5G coverage and more affordable 5G smartphones will drive 5G penetration further over the next two to three years. However, new and profitable industrial 5G use cases are still fairly distant and will remain a challenge for operators globally over the next few years.

2. Increasing competition, with aggressive pricing and new entrants

Operators in many APAC markets, such as Malaysia, Thailand, Singapore, and India, are continuing with aggressive pricing strategy and marketing to maintain their market positions. The entrance of new operators in Japan (Rakuten Inc.), Singapore (TPG), and Philippines (Dito Telecommunity Corp.) is also further increasing wireless market competition.

3. Deeper recession

Although benefitting from utility-like demand characteristics, deeper economic recession with reduced spending on telecom services and rising bad debt could dent the region’s telecom operators.

Initial 5G uptake is promising but more profitable industrial use cases remain distant

Korea made its first 5G rollout in April 2019, followed by Australia and China (see chart 16). Initial take-up of the services has been healthy in most of the regions, aided by the availability of high- and unlimited-data plans with minor pricing differential compared to 4G plans, wide range of 5G smartphones across varying price brackets, high speed, and support for cloud-based gaming and augmented reality. We expect better 5G coverage and more affordable 5G smartphones to drive 5G penetration over the next two to three years.

Chart 16
Cumulative 5G subscribers in Korea

Note: Korea switched on 5G services to general consumers from April 5, 2019. Source: Ministry of Science and ICT, S&P Global Ratings.
We expect ARPUs for Korean and Chinese telcos to benefit from the increasing 5G uptake over the next 12-24 months as data consumption grows at a faster pace, aided by higher 5G speeds, and the pricing of larger 5G wireless plans at a premium to 4G plans. That said, we do not expect the higher ARPU from 5G to translate into better margins for these telcos for at least the next few years. This is because the companies will have more marketing expenses to boost the uptake of 5G services and given that 5G base stations require higher electricity expenses and maintenance costs than those of 4G. We believe a significant improvement of ARPU and earnings from 5G services will be realized from critical B2B use cases and services but those use cases remain somewhat distant at this stage.

Given the distance between investment and payback, we believe 5G remains slightly negative for credit quality for now but may turn positive, aided by further ARPU growth and the development of new 5G use cases. As a result, we believe telecom operators will need to manage the investment burdens for 5G spectrum auctions and network expansions over the next few years. That said, realizing the timing gap in the investment and payback period, some telcos have engaged in co-building and co-sharing agreements to lessen their investment burden.

**Increasing competition, with aggressive pricing and new entrants**

Competition remains intense with deepening cuts in wireless tariff pricing or aggressive marketing in APAC countries such as Malaysia, Singapore, and Thailand. Furthermore, following government initiatives to promote competition, new operators have also entered or plan to enter in the markets of Japan, Singapore, and Philippines. This, we believe, will result in more wireless market competition and pressure on tariffs.

In Singapore, tariffs have come under additional pressure after the commercial launch of TPG in March 2020. The company has been offering cheap tariff plans to gain market share. Tariffs in Singapore have already fallen substantially across the board in the past few years, following the influx of MVNOs. In the Philippines, the entry of Dito Telecommunity Corp. slated for March 2021 will disrupt the long-held duopoly in the country, which could intensify price competition. In Japan, Rakuten Inc. commercially launched its mobile services in April 2020. The company aims to use new network technology based on virtualization and cloud to gain a significant cost advantage over rivals. Apart from Rakuten’s entrance, Japan’s telecom market also continues to face continued increasing pressure from the government to lower tariffs.

**Deeper recession**

Although telecoms benefit from utility-like demand characteristics, a deeper economic recession with reduced spending on telecom services and rising bad debt could dent the region’s telecom operators. We assume modest revenue and profitability decline in 2020, followed by a sector recovery next year and onwards.
Related Research

- **Telecom Fiber Sales: Limited Financial Benefits And Big Credit Questions**, Nov. 30, 2020
- **Credit FAQ: How A Big Election Win For The Democrats Could Affect U.S. Telecom And Cable Companies**, Oct. 27, 2020
- **Canadian Telecom Carriers Remain Resilient Through The COVID-19 Pandemic: Will They Have Enough Credit Bandwidth For 5G?**, June 18, 2020
- **Credit FAQ: Will U.S. Telcos Be Recession Proof This Time Around?**, April 8, 2020
- **COVID-19: EMEA Telecoms Will Prevail, But Not Completely Unscathed**, April 6, 2020
Industry forecasts

Telecommunications – Fixed and Wireless

Chart 16
Revenue growth (local currency)

EBITDA margin (adjusted)

Debt / EBITDA (median, adjusted)

FFO / Debt (median, adjusted)

Cable and Satellite

Chart 17
Revenue growth (local currency)

EBITDA margin (adjusted)

Debt / EBITDA (median, adjusted)

FFO / Debt (median, adjusted)

Source: S&P Global Ratings. Revenue growth shows local currency growth weighted by prior-year common-currency revenue-share. All other figures are converted into U.S. Dollars using historic exchange rates. Forecasts are converted at the last financial year-end spot rate. OEMs—Original equipment manufacturers. FFO—Funds from operations.
Cash, debt, and returns

Global Telecommunications

Chart 18
Cash flow and primary uses

Chart 19
Return on capital employed

Chart 20
Fixed versus variable rate exposure

Chart 21
Long term debt term structure

Chart 22
Cash and equivalents / Total assets

Chart 23
Total debt / Total assets

Source: S&P Global Market Intelligence, S&P Global Ratings calculations. Most recent (2020) figures are using last twelve months (LTM) data.