Telecoms

Healthy connectivity demand supports credit quality

January 9, 2024

This report does not constitute a rating action.

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What's changed?

Inflation curtails profitability growth but EBITDA margins are still growing on price rises and efficiency programs.

Lower debt issuance. This reflects choppy capital markets, higher interest rates, and back-ended maturity walls.

Mergers and acquisitions (M&As) have increased in some markets. Telcos are seeking market consolidation to relieve competitive pressure.

What are the key assumptions for 2024?

Steady earnings for 2024. A 3%-4% EBITDA growth in 2023-2025 on higher revenue and margins, given stable demand.

Intense competition in some markets. Higher churn rates and lower average revenue per user (ARPU) levels, given poor market conditions.

Varying capital expenditures (capex). Cuts in capex on lower 5G and fiber spending in developed markets, unlike in markets with lagging rollouts.

What are the key risks around the baseline?

Lower cash flow if interest rates stay high. This is the case for companies with near-term refinancing or unhedged floating-rate debt.

A recession could raise competition. Discounted offerings to maintain customer loyalty could jeopardize pricing and margins.

Risks from higher-than-expected investments, M&As, or shareholder returns. These factors could erode credit metrics.

Ratings Trends: Telecoms

Chart 1

Ratings distribution

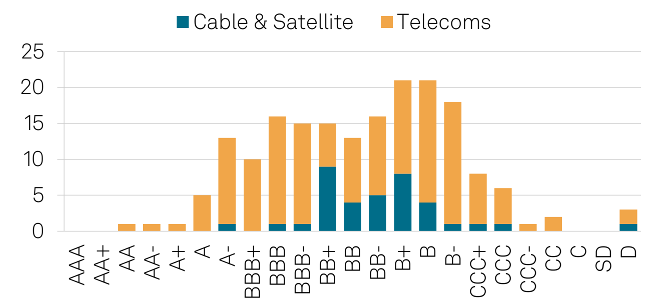


Chart 2

Ratings distribution by region

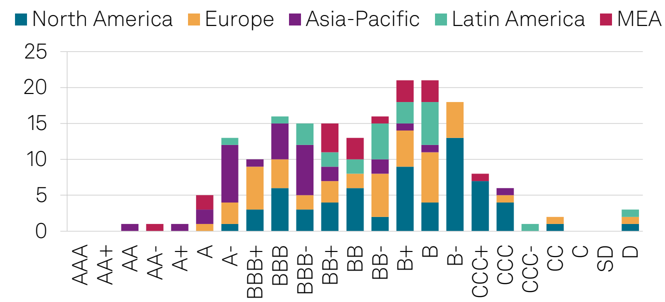


Chart 3

Ratings outlooks

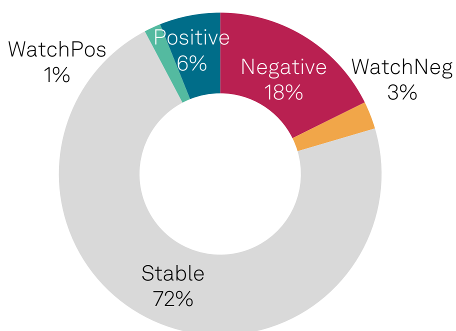


Chart 4

Ratings outlooks by region

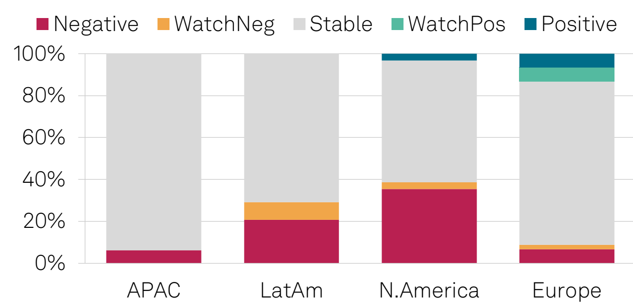


Chart 5

Ratings outlook net bias

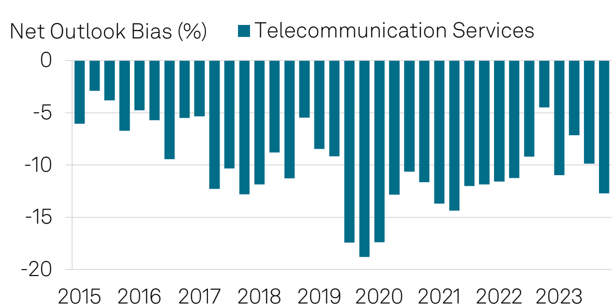
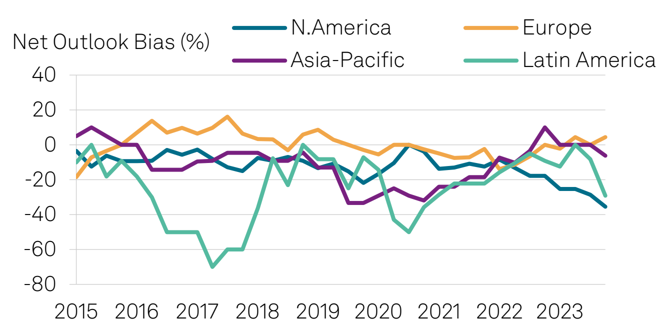


Chart 6

Ratings net outlook bias by region



Source: S&P Global Ratings. Ratings data measured at quarter-end.

Industry Outlook: Global

Ratings trends and outlook

Rating trends in the sector were moderately negative, with 39 downgrades, compared to 17 upgrades. The downgrade bias was mainly driven by the U.S. and Latin America (LatAm), and we expect this trend to continue. While about 72% of the telecom issuers have a stable outlook, negative outlooks increased, especially in North America and LatAm. In North America, the negative outlook bias has been mainly due to high interest rates and capital structures that can't absorb rising interest costs. In Chile and Colombia, intense competition and high capital needs hindered companies' cash flow, and consequently, increased leverage and tightened liquidity, which continued to weigh on credit metrics. Two percent of the region's rated issuers have a negative CreditWatch listing, mostly reflecting high refinancing risk and the increased potential for a downgrade.

In Europe, positive outlooks and CreditWatch positive placements have increased to 16% from 3% a year ago, and it's the only region with a positive rating bias. This is mainly because of M&As that reduce leverage or strengthen business profiles, the improvement in credit metrics, and revised sovereign outlooks in the region, such as that on Turkey. Overall, investment-grade companies constitute around one-third of the rated telecom entities, while the remaining ones are at speculative grade, primarily in the 'B' category.

For 2024, we continue expect stable trends. We expect moderate earnings growth as demand for data remains solid. EBITDA margins will be somewhat better because issuers are taking stringent cost-control measures to cope with higher operating costs and weaker global economic trends. We expect divestments will continue, given the need to create balance-sheet capacity for investments in networks or new revenue streams in business segments adjacent to traditional telco services to boost long-term earnings potential, especially in Asia-Pacific (APAC), LatAm, and the Gulf Cooperation Council (GCC). However, in the U.S., adverse trends will remain in place across telecom and cable issuers, as about 20% of the rated entities are in the 'CCC' rating category. Many of these issuers have floating-rate debt, so if high interest rates and volatile economic conditions continue, cash flow will weaken, hurting liquidity.

Main assumptions about 2024 and beyond

1. Earnings will remain steady for 2024.

We expect revenue growth averaging 2% for 2024, thanks to increased mobile data traffic, fixed mobile adoption in some markets like the U.S., lingering inflationary cost pass-throughs, and stable demand for telecom services in general.

2. Intense competition will continue.

High competition in markets with four or more players will remain in place, pressuring ARPUs and profitability.

3. Capex growth will vary regionally.

Capex will depend on the investment cycle that companies are in, with respect to the deployment of 5G and fiber technology.

Earnings will remain steady for 2024. Overall, we expect top-line growth for telcos will remain stable across regions. We expect growth in low- to mid-single-digits in most of the regions, reflecting stable demand for telecom services despite high competition, while a focus on cost-efficiency measures should support earnings growth.

In the U.S., wireless service revenue is likely to grow about 3% during this year and 2.5% in 2024 due to rate increases on legacy plans, customer migration to more expensive 5G plans, and growth from fixed wireless access (FWA). For cable operators, we expect a low-single-digit growth during 2024, reflecting broadband ARPU growth, improving wireless economics, business services, and footprint expansion.

In Canada, we expect mid-single digit growth in 2024 because of high immigration-led population growth and increasing penetration, partly offset by higher churn and increased competition, among other macroeconomic effects.

In Europe, we expect top-line growth to average 1%, slowing with inflation. Still, more sustainable competition levels should allow continued contract-based price increases on post-paid subscriptions, ad-hoc increases, and reduced promotional discounts for new customers. Combined with margin improvements, earnings are poised to grow 3%-4%

In LatAm, revenue growth will be modest, in line with the expectations for economic growth in the region.

In APAC, we expect mid-single-digit revenue growth for 2024, given increased mobile data traffic and fixed broadband adoption.

Intense competition in some markets will continue. Highly competitive market conditions, including the entrance of new players in some markets, have been disruptive for existing participants. Several telecom operators have been struggling to retain market share and have experienced churn-rate increases. To maintain market share, these companies have cut prices and extended promotional packages, lowering ARPU. This, together with cost pressures, could drag down companies' profitability and earnings. In this scenario, we will see weaker-than-average performance in countries with high competition.

In Italy, for example, Iliad Holding S.A.S. is a recent entrant and aggressive competitor that has quickly increased market share, limiting overall growth in the domestic market compared with other markets in Europe. Similarly, with the entrance of WOM S.A. into the Colombian and Chilean markets, several telecom operators have been experiencing a decline in ARPUs to defend their customer base amid intense competition.

However, in markets with three or fewer operators and with balanced market shares, we may see better performance. Such markets, sometimes as a result of consolidation, tend to be more stable and have lower churn levels. If supported by a predicable regulatory framework and higher interest rates suppressing non-sustainable pricing, competition should moderate, improving prices, and increasing growth prospects.

Capex is down overall but varies regionally. Capex will depend on the state of 5G and fiber rollout of telcos. Investments have fallen in 2023 in the U.S., Canada, and EMEA markets, where deployment is in the final stages. Fiber rollout is near completion for many markets in these regions, and 5G spending has slowed down after extensive investments for initial rollouts. We expect a 10% decline in capex among U.S. telcos, based on a slower pace of investments in wireless and wireline services.

We also expect average capex intensity in EMEA will fall and remain near 17% of revenue, down from its 20% peak in 2021, which should continue to improve cash flow and financial flexibility.

The same approach has been evident in Canada, where we expect telcos will ease capital intensity to bolster free operating cash flow (FOCF) during 2024.

In APAC, as the first wave of 5G investments is over, companies are more focused on network quality spending, while investments for new technology will remain cautious.

Meanwhile, LatAm remains in the initial stages for 5G, and capex will remain elevated. We believe that incumbent players are more likely to be the main 5G providers due to their greater financial flexibility with higher profitability margins and stronger liquidity positions, allowing for larger investments in the new technology.

Credit metrics and financial policy

We expect modest improvement in credit metrics through 2024, but the positive rating momentum will require clearer financial policy commitments. Most operators are generating modest EBITDA growth and cash flow because of cost-cutting initiatives and lower capex. As a result, we expect some improvement in FOCF and increased financial flexibility. But because of our forecast of a relatively low growth, persistently high interest rates, and lingering inflation (especially on the labor front), financial policies will need to prioritize debt reduction to translate better cash flows into rating upside, especially when refinancings arrive and capital structures reset at higher rates.

We expect asset sales to continue during 2024. Telcos started selling tower portfolios and, more recently, fixed-network assets. These sales have improved telcos' financial flexibility by strengthening their balance sheets, and could have a significant impact on reducing investment requirements, boosting FOCF in 2024. But this trend may be compromised if the sales of strategic assets impair telcos' business profiles, a risk we view more prominently with fiber sales.

Key risks or opportunities around the baseline

1. Lower cash flows for operators with leveraged capital structures if interest rates remain high.

Companies with refinancing needs or unhedged floating-rate debt face higher interest rates, which will weaken cash flow and interest coverage metrics, increasing ratings pressure.

2. A recession could heighten competition if reduced discretionary spending makes consumers more price sensitive.

Telcos may expand offers of attractive products and packages to maintain customer loyalty, hampering their ability to maintain or increase pricing, eventually eroding margins.

3. Increasing investments or shareholder returns could limit credit metric improvements.

If companies start facing pressures for higher shareholder returns or accelerated investments, credit metrics could deteriorate.

Cash flows of telcos with leveraged capital structures could fall if high interest rates continue. Telcos will have to navigate a slower economic growth environment, and high inflation and interest rates. This could pressure speculative-grade issuers in particular, for which high leverage makes liquidity management, FOCF, and interest coverage key to maintaining creditworthiness.

We have seen companies taking advantage of low interest rates in the recent past, and liability management has been essential in preventing refinancing risks. However, companies with significant short-term debt maturities or unhedged floating-rate debt face higher interest rates, which will dent cash flow and interest coverage metrics, ratcheting up pressure on ratings.

Prolonged high interest rates could also constrain access to capital markets for some companies, weakening liquidity.

A recession could heighten competitive pressure if reduced discretionary spending makes consumers more price sensitive. If telcos need to expand offerings of attractive products and packages to maintain customer loyalty, it could hamper their ability to maintain or increase pricing. Price competition could increase churn and weaken ARPU and revenue as companies will need to lower prices and bundle packages to retain customers. This could result in slower upgrades to higher-priced plans and longer handset replacement cycles, especially in the price-sensitive and predominantly prepaid markets.

Increasing investments or shareholder returns could limit credit metric improvement. We believe companies will maintain financial discipline amid the currently weak economic environment. In regions where moderate EBITDA growth and declining capex are improving cash flow and financial flexibility, we expect a balanced approach to deleveraging, investments, and shareholder returns. However, if companies start facing pressures for higher shareholder returns or accelerated investments, including debt-funded M&As, their credit metrics could weaken.

Industry Outlook: North America

Rating trends and outlook

More negative rating actions in 2024. Notwithstanding solid industry fundamentals, downgrades outpaced upgrades by five to one in the U.S. due to high interest rates and capital structures that couldn't absorb rising interest costs. About 20% of the rated telecom and cable issuers in the U.S. are now in the 'CCC' category, and the outlook bias is increasingly negative, with about one-third of our ratings on a negative outlook or on CreditWatch with negative implications.

In 2024, we expect downgrades will continue to outpace upgrades across U.S. and Canadian telecom and cable operators, as highly leveraged capital structures are increasingly stressed by elevated interest expenses, primarily among issuers in the lower end of the ratings scale. We therefore expect the percent of issuers in the 'CCC' category to increase. Many of these companies have a significant amount of floating-rate debt that will depress cash flow and liquidity.

Main assumptions about 2024 and beyond

1. Modest service revenue and earnings growth in the wireless market.

We forecast a 2.5% industry service revenue and 5% EBITDA growth in 2024 due to rate increases, customer migration to more expensive 5G data plans, postpaid net adds, and growth from FWA.

2. A low-single-digit EBITDA growth for cable in 2024.

We project modest EBITDA growth will primarily stem from higher broadband ARPU, footprint expansion, business services, and improving wireless economics for the larger operators, which will be partly offset by modestly lower broadband penetration levels due to elevated competition from FWA and fiber to the home (FTTH).

3. Telcos' capex to decline, while cable investments to increase.

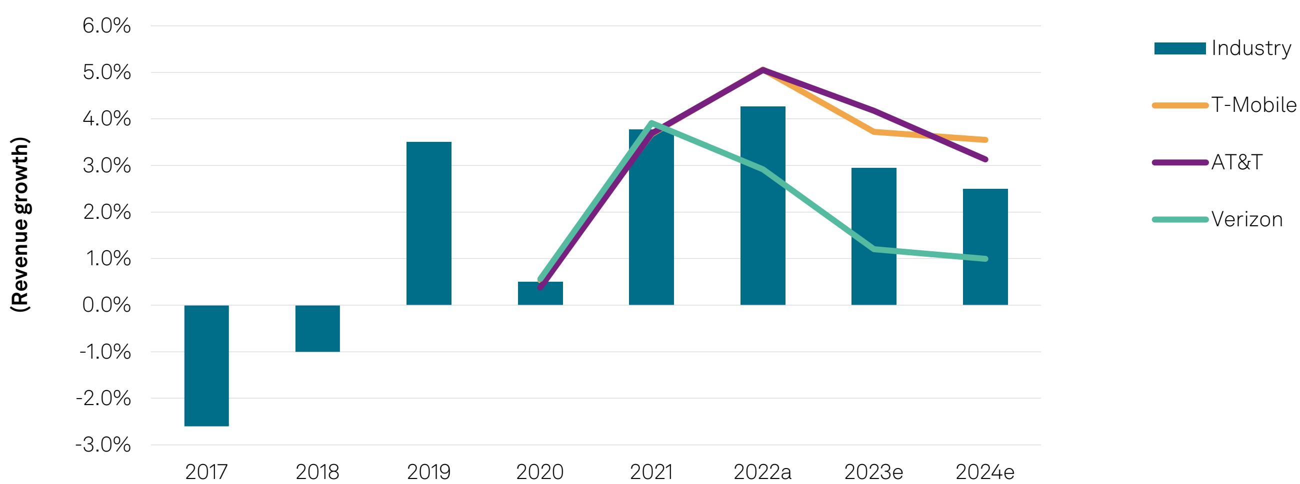
We expect capital intensity to decline in the wireless segment as carriers wind down their initial 5G network builds. In the cable segment, we expect capex to increase modestly to enable multigigabit download speeds and at least 1 Gbps upload speeds.

U.S. wireless subscriber and service revenue growth to slow in 2024. Overall, wireless postpaid subscriber trends remained healthy during the first nine months of 2023 despite maturing industry conditions, although cable took a larger share. We expect more of the same in 2024 (see chart 7), although the pool of potential customers continues to shrink, and we forecast a 7%-9% decline in postpaid phone net adds during the year. Furthermore, we expect cable's share of postpaid phone net adds will increase to almost 52% from 45% in 2023.

Excluding Verizon Communications Inc.'s reclassification of wireless "other" revenue into service revenue, we expect overall industry wireless service revenue growth of about 3% in 2023, down from 4% in 2022. Notwithstanding our expectation for slowing postpaid subscriber growth and prepaid losses, we forecast the industry's service revenue will rise by about 2.5% in 2024 due to rate increases on legacy plans, customer migration to more expensive 5G rate plans, and growth from FWA. We also expect upgrade rates will remain low in 2024 as consumers hold on to their handsets for longer periods, given the limited appeal of new devices and the migration of customers to three-year contracts from two years, which reduces monthly handset expenses. While this will continue to pressure equipment revenue, it also benefits carriers' profitability since they don't earn any money from handset sales. Coupled with cost-reduction initiatives and improved spectral efficiency from 5G wireless technology, we expect 3% earnings growth in 2024, somewhat lower than our forecasted 5% growth in 2023.

Chart 7

U.S. wireless annual service revenue growth rate



a—Actual. e—Estimate. Source: S&P Global Ratings.

Cable earnings to grow in low-single digits in 2024, aided by wireless (see chart 8). We project that modest EBITDA growth will primarily result from higher broadband ARPU, footprint expansion, business services, and improving wireless economics for the larger operators, which will be partly offset by modestly lower broadband penetration levels due to elevated competition from FWA and FTTH.

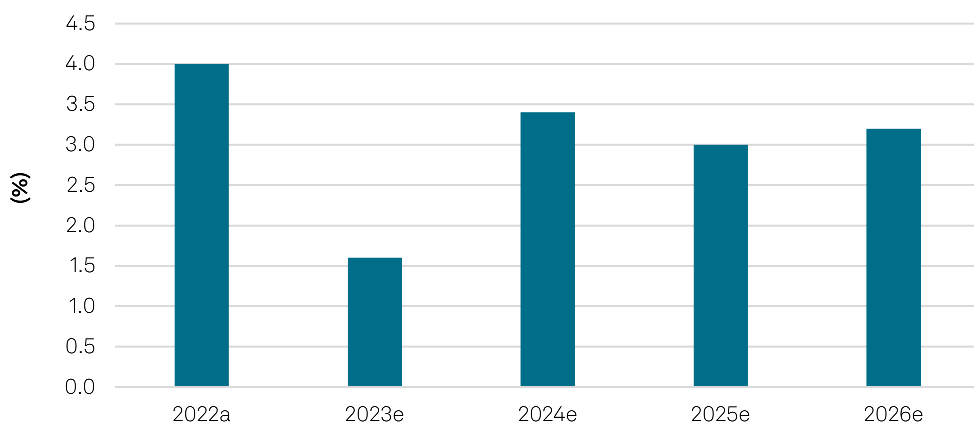
We believe attractively priced mobile wireless serves as a powerful broadband churn reduction mechanism for large cable operators. Given the capital-light nature of the service and that these operators aren't running wireless to maximize stand-alone profits, we believe they can match or exceed any discount on broadband offered by a FWA or FTTH competitor, particularly considering the average wireless spend is 3x the in-home broadband bill. We believe this will continue to limit subscriber losses, despite elevated competition.

Separately, for large cable operators, we believe wireless offerings will bolster EBITDA growth in the next three years as the drag from new customer additions is more limited, start-up costs ease, and overhead can be spread over a larger customer base. Both Comcast Corp. and Charter Communications Inc. have about 10% of broadband homes on wireless plans, so we believe there is substantial room for growth with an economically healthy mobile virtual network operator (MVNO). We believe the economics will improve over time as these companies move traffic on-network, utilizing their holdings of Citizens Broadband Radio Service spectrum licenses via stand-mounted small cells.

For smaller operators, we believe wireless will be a drag on profitability initially. It took Comcast about four years to reach stand-alone profitability. Given their more limited scale, these smaller operators may not receive such attractive terms on their wholesale MNVO arrangements, which could limit their ability to price as aggressively as Comcast and Charter. Furthermore, certain highly leveraged operators such as Altice USA Inc. don't have the financial flexibility to absorb wireless losses, which could limit their effectiveness.

Chart 8

U.S. cable industry weighted average EBITDA growth



a—Actual. e—Estimate. Source: S&P Global Ratings.

In Canada, we expect telecom revenue to rise by low- to mid-single-digits. The Canadian industry is largely vertically integrated, including significant media ownership. Following the merger of Rogers Communications Inc. (RCI) and Shaw Communications Inc. earlier this year, the three incumbent players (Bell Canada Inc., RCI, and Telus Corp.) generate more than 90% of Canadian telecom revenue. We anticipate underlying earnings growth for the sector in 2024 to stem from immigration-led population growth, sustained ARPU, strong roaming revenue, and digitization, offsetting higher competition, weakening affordability, inflation, and other macroeconomic effects. However, large restructuring charges will undermine reported earnings. We also believe lower wireless penetration (than in the U.S. and Europe) and increased immigration through 2025 will continue to support wireless revenue growth.

Canadian carriers have benefited from the convergence approach, and we expect them to further integrate their services and support bundled offerings, increasing competition. With FTTH covering a significant portion (70%-80%) of Bell's and Telus' broadband footprints, competition has surged in the broadband space, with telcos getting most of the net adds compared with cable operators. At the same time, with RCI completing the merger with Shaw and Videotron Ltd. acquiring Freedom Mobile Inc.'s wireless assets earlier in 2023, we expect competition to increase in the wireless and broadband sectors as both RCI and Videotron start providing services nationwide. We view Telus as most at risk from the increased competition in western Canada. In our view, both competitive and regulatory risks are likely on the rise in the near term.

Telcos' capex will continue to decline in 2024. We expect U.S. telcos' capex to drop by about 10% in 2024 following an approximate 12% fall in 2023. We base our forecast on the following factors:

- We expect wireless capex to decline by about 9% in 2024 as mid-band spectrum deployments are largely completed and the initial surge from 5G spending winds down. Furthermore, T-Mobile US Inc. continues to realize capex synergies from its acquisition of Sprint Corp.
- Wireline capex to decline by about 10% in 2024 following a 1% increase in 2023 as the wireline operators scale back their FTTH builds to conserve cash flow amid high interest rates. Lumen Technologies Inc. announced that its capex will decline by $200 million-$300 million in 2024 as it moderates the pace of fiber builds. Consolidated Communications Holdings Inc. plans to pass 75,000 homes in 2024, down from 222,000 in 2023. While we expect Frontier Communications Holdings LLC will maintain its fiber build pace of about 1.3 million passings, we also believe it will increase its mix of lower-cost deployments (i.e. lower cost per passing).

In line with the U.S., capex among Canadian telcos is also likely to decline as both Telus and BCE Inc. complete the majority of their fiber build and return capex to normal levels; BCE has announced it will curb capex by an additional $1 billion in 2024-2025 in response to the regulatory decision. We expect telcos' easing capital intensity to strengthen FOCF in 2024. RCI's capex, pro forma the merger with Shaw, as well as that of Videotron are likely to increase significantly but still stay within the usual capital intensity level. Overall, capital intensity among Canadian players will remain in the 16%-18% range of telecom revenues. The C-band spectrum auction spending was only $1.9 billion for incumbents (including Videotron), although cash payments are not due until the second quarter of 2024.

Cable capex will increase in 2024. We believe the coaxial network upgrade cycle that most cable operators will embark on in the next three years is necessary and will provide a path toward long-term ARPU growth while also serving to protect existing market shares. These upgrades are within the historical capital spending levels of 12%-14% of revenue and can be achieved for a relatively affordable amount of $100-$200 per home passed. These investments will enable multigigabit download speeds and at least 1 Gbps upload speeds, which are important from a marketing and competitive standpoint.

We also view rural footprint expansion favorably, provided that it doesn't increase financial leverage but rather comes in lieu of shareholder returns, which we expect for most cable providers. Government-subsidized rural footprint expansion will help drive subscriber and EBITDA growth because there's no competition from fiber in these markets, so customer penetration will likely be above average. We believe this will be the primary driver of subscriber growth in the future, given the increasingly competitive and mature conditions in incumbent markets.

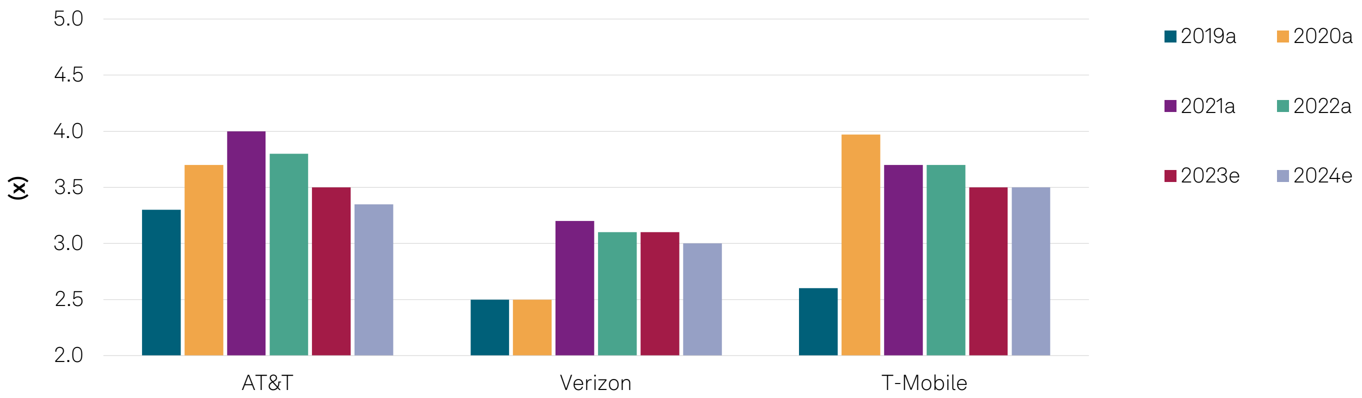
Credit metrics and financial policy

We expect modest improvement in credit metrics for large telcos. We assume earnings growth and lower capex will improve FOCF and adjusted leverage in 2024 (see chart 9). That said, our base-case forecast doesn't include any shareholder distributions beyond what has been communicated by the companies, although we believe there's greater risk that new share repurchase programs are initiated by AT&T Inc. and Verizon, which limits leverage improvement.

For T-Mobile, we expect shareholder distributions will offset earnings growth and FOCF, such that leverage remains steady in the mid-3x area.

Chart 9

U.S. wireless adjusted debt-to-EBITDA



a—Actual. e—Estimate. Source: S&P Global Ratings.

Wirelines continue to face headwinds in 2024. While the outlook for U.S. wirelines could be favorable in the longer term, we expect challenges to persist in 2024, resulting in weak credit metrics at a time when they're trying to reverse the trajectory of earnings declines. High interest rates, inflation, and exposure to legacy revenues such as multiprotocol label switching (MPLS) and digital subscriber line services will continue to weigh on credit quality of U.S. wirelines as they transition their business to FTTH.

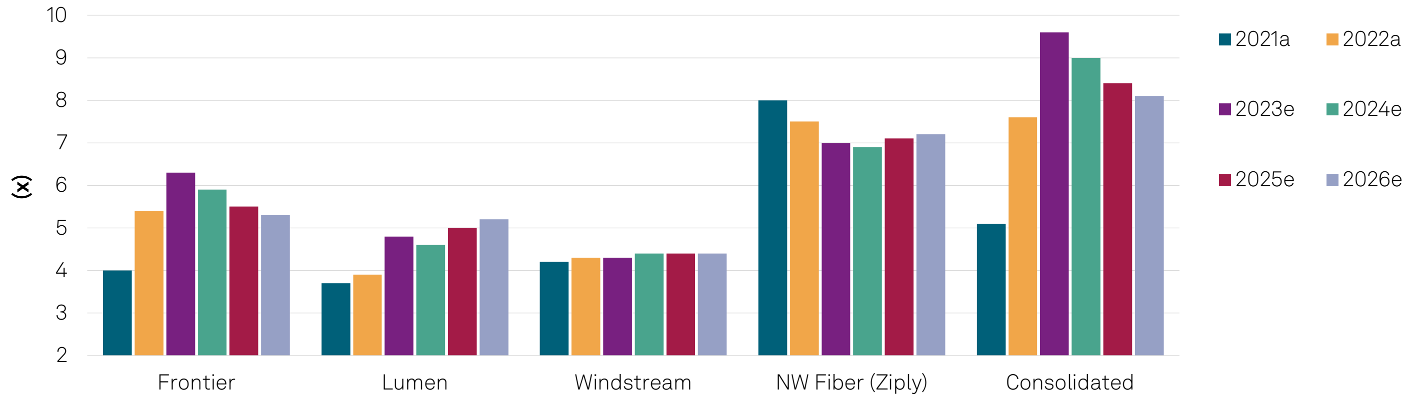
We expect overall pressures to continue in 2024 with revenue declining 4%-5%, although results will vary by provider, depending on how far along they are with their fiber builds. At the same time, we expect revenue from business services will continue to fall by high-single digits due to reduced IT spending and exposure to legacy products and services. However, our base-case forecast assumes the industry will begin to see favorable earnings trends by 2025 due to the following:

- Increasing fiber coverage should start to yield benefits even if the fiber broadband subscriber growth is not sufficient to offset losses from copper, since FTTH customers typically generate higher ARPUs, which should rise over time as they move to higher-tier data packages.
- Greater scale and cost-cutting initiatives following several years of buildout activity.
- Potential recovery in IT spending once economic growth picks up in 2025.

Despite our expectation for lower capex in 2024, we expect credit metrics, including adjusted leverage, will remain weak during the year because we assume higher interest expense will continue to pressure FOCF even if industry EBITDA grows (see chart 10).

Chart 10

U.S. wireline adjusted debt-to-EBITDA



a—Actual. e—Estimate. Source: S&P Global Ratings.

Credit metrics in the Canadian telecom industry should show modest improvement through 2024. Telcos' easing capital intensity should strengthen FOCF in 2024 and afterward for BCE and Telus. RCI continues to deleverage, and our base-case scenario assumes leverage to hit low-4x in the third year following the close of the merger. In our view, the C$2.2 billion paid by the industry for the 3.8 GHz spectrum auction (significantly lower than the 2021 $8.5 billion 3.5 GHz spectrum auction) and moderating capex partly compensate for the increasing competitive intensity, regulatory headwinds, and aggressive financial policy, which we view as risks to a consistent pace of deleveraging.

U.S. cable credit metrics should remain stable in 2024. We expect U.S. cable providers' adjusted debt to EBITDA will be relatively stable as most operators are still generating modest EBITDA growth and cash flow, with the ability to manage leverage according to their targets. However, financial flexibility will decline, given elevated capital spending associated with network upgrades and footprint expansion, which will pressure the FOCF-to-debt metric to some degree.

Key risks or opportunities around the baseline

1. High-for-longer-interest rates and looming debt maturities weigh on high-yield credits.

While investment-grade companies should be able to manage their debt refinancing, there's greater risk for speculative-grade U.S. telecom and cable issuers, specifically at the lower end of the rating scale.

2. U.S. telcos may allocate excess cash flow to shareholder returns.

We currently expect telcos to generate greater FOCF and focus on leverage reduction. However, lagging stock prices could push companies to allocate a larger share of their FOCF to shareholder returns.

3. FWA and FTTH competition causes broadband subscriber losses to increase, leading to lower earnings.

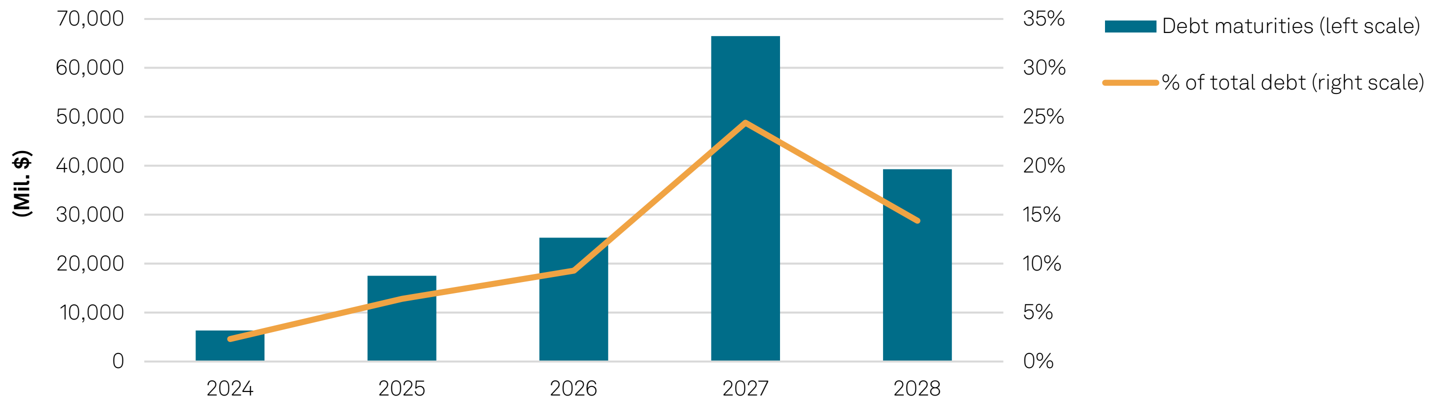
While we currently forecast a 3.0%-3.5% EBITDA growth, increasing competition from FWA and FTTH could result in high-speed data (HSD) subscriber losses, reducing earnings.

High-for-longer interest rates could strain speculative-grade rated issuers. That said, overall, we believe the speculative-grade telecom and cable sector has sufficient breathing room for deleveraging or to refinance well in advance of their debt maturities. We estimate there's about

$6 billion of speculative-grade telecom and cable debt that matures in 2024, or 2% of the total (see chart 11). The amount increases to about $17.5 billion in 2025 (6%) and to $25 billion in 2026 (9%). Among issuers rated 'B' and below, we estimate that about $5.5 billion of debt matures in 2024 (4%), $8 billion in 2025 (7%), and $16 billion in 2026 (13%). The big refinancing wall for speculative-grade U.S. telecom and cable issuers won't occur until 2027, when almost 24% of outstanding debt will need to be refinanced, and among issuers rated 'B' and below, the percent will be about 30%.

Chart 11

U.S. speculative-grade telecom and cable debt maturity profile



Source: S&P Global Ratings.

Not surprisingly, issuers that have the greatest refinancing risk are in the 'CCC' category and include:

- **Dish Network Corp./DISH DBS Corp.:** The company faces large debt maturities of $2.9 billion in 2024, $2.0 billion in 2025, and $7.7 billion in 2026, while generating a FOCF shortfall. While the company's proposed all-stock merger with Hughes Satellite Systems Corp. will bolster its liquidity position--which includes about $2 billion of cash, marketable investments, and $250 million-$300 million of FOCF--it will be very difficult for Dish to refinance its upcoming obligations at an affordable rate.
- **Lumen:** The company entered into a transaction support agreement (TSA) with a group of its creditors holding about $7 billion of its outstanding debt. The company currently has about $1.7 billion due in 2025, $498 million in 2026, and $9.5 billion due in 2027. While the TSA would enable the company to push out the bulk of its debt obligations to 2029 and 2030, giving it time to execute its turnaround strategy, the agreement still doesn't have enough support from its creditors to initiate the transaction.
- **Anuvu Corp.:** The satellite connectivity provider's adjusted leverage remains elevated, at above 10x, and higher interest rates have depressed the company's FOCF and liquidity. While there's no debt repayment due in 2024, almost half of its debt obligations come due in 2025 and the remaining amount in 2026.
- **Logix Intermediate Holdco.:** The fiber bandwidth provider has about $175 million of first lien debt due in December 2024 and another $125 million of second lien debt due in 2025.

Increasing pressure for shareholder returns could constrain the improvement in credit metrics of large U.S. telcos. Both AT&T and Verizon raised their free cash flow guidance for 2023 due to cost savings, working capital efficiencies, and better operating trends. AT&T increased its free cash flow outlook to $16.5 billion from $16.0 billion, notwithstanding the use of excess cash flow to pay down its vendor and direct supplier financing obligations, which we include in our adjusted leverage calculation. Verizon raised its free cash flow guidance to $18 billion from $17 billion despite capex coming in at the higher end of its $18.25 billion-$19.25 billion guidance.

While we expect telcos to prioritize debt reduction, given high interest rates, lagging stock prices could prompt companies to increase shareholder returns sooner than expected. Verizon's reported net unsecured debt to EBITDA was 2.6x as of Sept. 30, 2023, and management indicated it could buy back stock once this metric hits 2.25x. We believe the company can reach this leverage level by mid-2025. However, we believe there's greater risk that it initiates a share repurchase program prior to reducing its net unsecured leverage to 2.25x if equity returns don't improve. Similarly, we believe AT&T will reach its net leverage target of 2.5x in the first half of 2025, but the need to appease shareholders may force management to repurchase shares at the expense of creditors.

We could adjust our rating triggers for cable operators if business prospects weaken and competition is more intense than we expect. Although currently not part of our base-case scenario, if competition from FTTH and FWA increases, resulting in persistent earnings declines for U.S. cable providers, we could revise our rating triggers. This could be caused by higher-than-expected FWA subscriber growth and network investments, FTTH penetration exceeding our long-term expectations of about 55% of the U.S., or greater-than-expected pricing pressure from new competitors. Therefore, we will be closely monitoring operating metrics such as HSD ARPU growth, HSD subscriber trends, wireless growth and profitability, and footprint expansion initiatives.

Industry Outlook: EMEA

Ratings trends and outlook

We expect stable ratings in 2024, thanks to incremental revenue and profitability gains, and lower capex. As inflation subsides, price hikes will moderate and revenue growth is likely to slow in 2024. However, EBITDA growth and lower capex should continue to improve cash flows and financial flexibility, and the rating headroom potential, though only sufficient for the rating upside in a few cases.

We enter 2024 with negative outlooks and CreditWatch placements on 6% of our ratings (down from 18% a year ago). This is more than offset by positive outlooks and CreditWatch placements, resulting in a positive bias of about 10%. The decline in negative outlooks and CreditWatch placements partly reflects the resolution of prior outlooks to downgrades. The remaining negatives reflect weak credit ratios (Bouygues S.A.) as well as refinancing and sustainability concerns (TalkTalk Telecom Group PLC and Eolo S.p.A.).

Positive outlooks have increased to 16% and stem from M&As (TIM, PPF Telecom Group B.V., and Lorca Telecom BidCo S.A.U.), improving credit metrics (Swisscom AG, Cellnex Telecom S.A., and United Group B.V.), and revised sovereign outlooks that cap our ratings (Turk Telekom and Turkcell Iletisim Hizmetleri S.A.). Of our European telecom ratings, 78% carried a stable outlook (compared with 70% a year ago), and Europe has the strongest regional balance globally.

Downgrades and upgrades in 2023 were balanced at five each, reflecting the sector's stability, as 80% of ratings were unchanged. Downgrades resulted from idiosyncratic, rather than sector-wide, operational factors. These included leveraged financing for M&As (Eutelsat Communications S.A.), weak credit ratios and cash flow shortfalls (Proximus S.A., Altice France S.A., and TalkTalk), along with Tele Columbus AG, which we downgraded twice on its path to default. This was balanced by our upgrades stemming from deleveraging (Deutsche Telekom AG, Matterhorn Telecom S.A., and Zacapa S.a.R.L.), and for upgrades of linked entities (Hellenic Telecommunications Organization S.A. and Turkcell).

Main assumptions about 2024 and beyond

1. Revenue gains will likely slow as inflation begins to abate, and earnings rise on margin growth.

We expect revenue growth averaging 1% in the next two years, lower than in the last two years as slowing inflation dampens CPI-linked price increases. Cost control from efficiency programs, realization of synergies, and lower energy costs will increase margins and EBITDA gains, despite labor costs that will continue to climb.

2. Capex will decline to a sustainably lower level for the next few years, improving cash flow.

We think telcos' capex to support fiber and 5G mobile rollouts peaked in 2021 at 21% and will decline to about 17% in 2023. This new level should be sustainable, improving FOCF, though we expect variation around the average based on the degree of buildout progress in various markets.

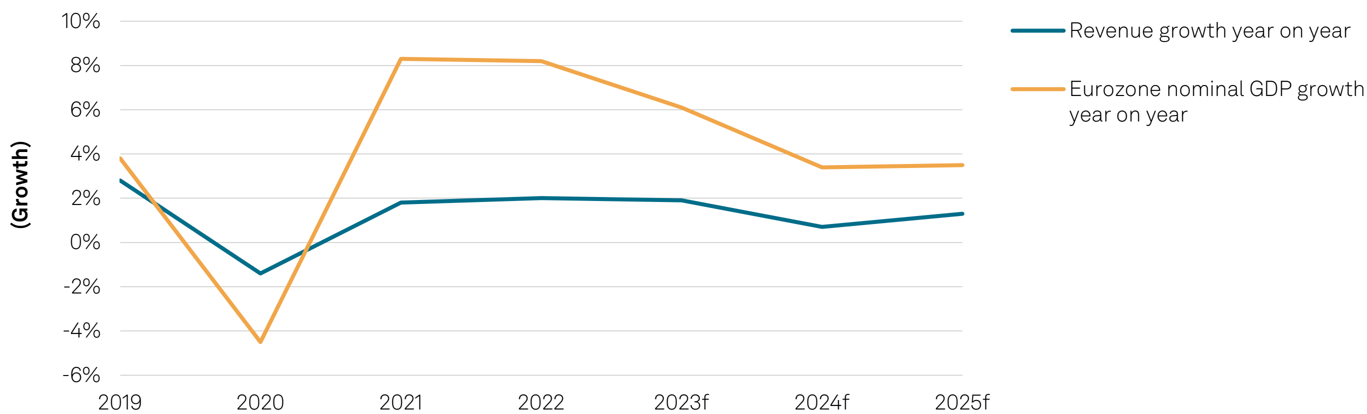
3. Improved cash flow will raise financial flexibility, but with no material rating upside, unless supported by conservative financial policy

Revenue and margin growth and lower capex should strengthen cash flow and financial flexibility for many operators. Credit impact will depend on financial policy and management prioritization between deleveraging, accelerated investments, M&As, and shareholder returns.

Revenue gains will slow as inflation begins to subside, and we expect a faster rise in earnings on margin growth. Led by the U.K., Belgium, Portugal, and the Nordics, service revenue trends have broadly turned favorable in the past two years (see chart 12). This is thanks to contract-based inflation indexation on post-paid subscriptions in several markets, ad-hoc increases in others, and a reduction in promotional activity to lift the front book--that is, price plans for new customers. We expect this will continue to support top-line revenue growth of slightly more than 1% on average for 2023-2025. Given our base-case assumption of a 3.4% nominal GDP growth in 2024 for the eurozone, telecom revenue growth will lag inflation and be negative in real terms.

Chart 12

European telcos' and cablecos' revenue growth lags GDP growth



f—Forecast. Source: S&P Global Ratings.

Growth rates are uneven across markets. Countries with intense competition and challenging market structures will continue to see weaker-than-average telecom performance. Italy and France, for example, have four-player markets with an aggressive price competitor. In both cases, this entity is Iliad, whose Free brand has been gaining customer share at the expense of existing players. In France, Iliad has been able to drive up its ARPU without raising prices by migrating customers to its higher-end offer from its basic plan. This has limited price increases among competitors, as they risk an increase in churn if they raise rates more aggressively.

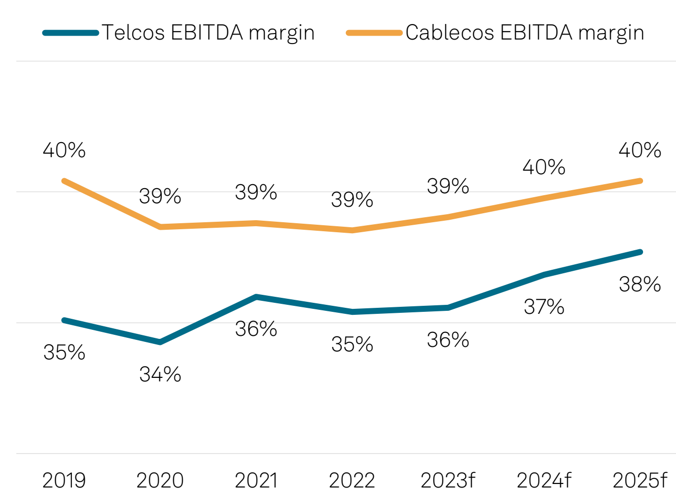
The boost from contractual price increases and reduced promotional activity will dissipate in the next two years. Our macroeconomic forecast for inflation of 2% by late 2025 means the tailwind from automatic contractual price increases will subside in the next two years. This will test telcos' ability to continue making gains from pricing. Meanwhile, we don't view the reduction in promotional offers as an ongoing growth driver. Once the discount or the discount period is reduced, the benefit is harvested and can't be reaped again in the same way that price increases can. And, in our view, such reductions are more likely than price increases to reverse if competition ramps up.

We expect a steady rise in margins despite lingering inflation. We expect European telcos to realize modest profitability gains, pushing EBITDA margins up by about one percentage point annually through 2025 (see chart 13). The fall in energy costs has boosted EBITDA, and a drop in low-margin equipment sales has improved the revenue mix. Labor costs are moving front and center in telcos' cost structures this year and in 2024, as measures of inflation (like the producer price index and consumer price index) fall, while wage growth, still above 7%, remains higher.

Wages typically constitute 15%-20% of telcos' revenue, so a 5% increase in wages erodes margins by about 1%. Wages are also stickier and unlikely to fall as energy costs have done over the past year. We therefore forecast labor costs will counterbalance margin expansion. However, the offsetting factors are the drop in energy prices; the effect of longstanding efficiency programs, including workforce reductions, digitalization, and enhancement of sales channels and customer service using artificial intelligence; and the growing shift to fiber networks, which have lower operating costs than copper networks.

Chart 13

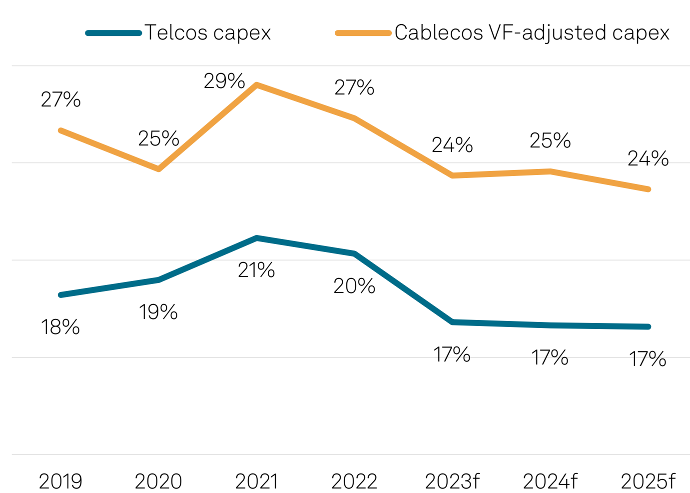
European telecoms average margins (% of sales)



f—Forecast. Source: S&P Global Ratings.

Chart 14

European telecoms average capex (% of sales)



f—Forecast. Source: S&P Global Ratings.

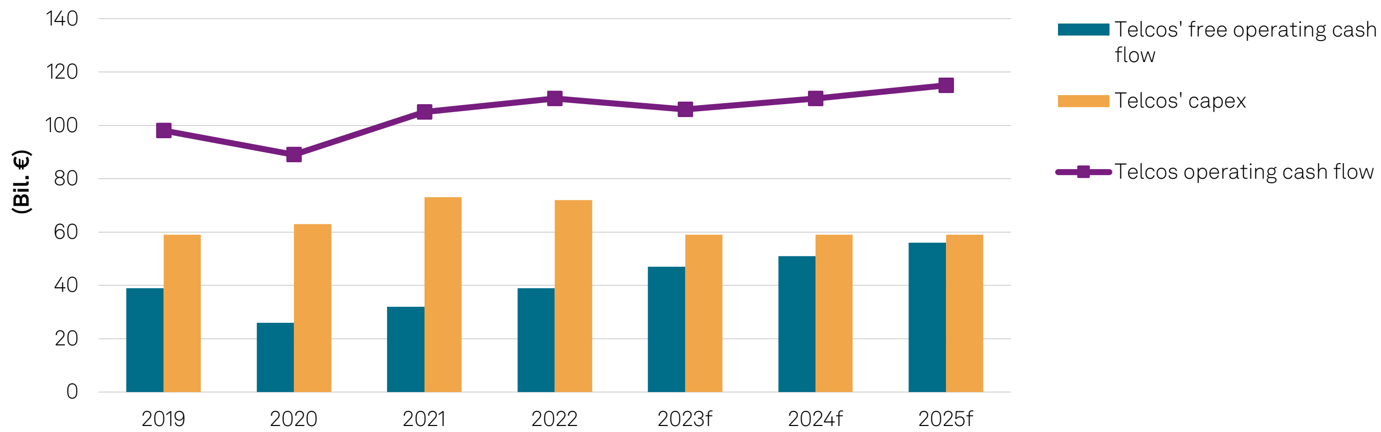
Capex will shrink to a sustainably lower level for the next few years, improving cash flow. After remaining chronically elevated for a decade due to 4G rollouts and long-term densification, fiber, and then 5G, capex has dropped sharply in 2023, averaging 17% of revenue, and will remain stable at that level through to 2025, in our view (see chart 14). But the trend is uneven among markets. The drop is mainly due to primary fiber rollouts nearing completion in large markets like Spain and France, and to a lesser extent a slowdown in 5G spending after the peak of the initial rollouts in many markets.

As operators decommission their copper networks, the lower maintenance capex associated with passive fiber networks should allow them to reduce investments. We expect incumbents like Orange S.A. will see capex intensity fall to 16% in 2023 and to 15% in 2025, and Telefonica S.A. to 14% and 12%, respectively. On the other hand, with fiber rollouts in the U.K. and Germany--two markets that are significantly behind in fiber coverage--only now reaching full throttle, capex of telcos there will remain above 20%. We forecast that British Telecommunications PLC will have a 24% capex intensity through to 2025. But in aggregate, the falling capex intensity is good news for telcos' cash flows.

Improved cash flow will raise financial flexibility, but without material rating upside, unless supported by conservative financial policy. The recent expansion in FOCF should continue, more than doubling from the 2020 level by 2025 (see chart 15). This, along with EBITDA expansion, should give telcos the financial flexibility to reduce leverage and increase the rating headroom amid tighter funding conditions. However, companies are facing competing priorities, and the credit impact will depend on financial policy and relative prioritization between deleveraging, accelerated investment, M&As, and shareholder returns.

Chart 15

European telcos' consolidated operating cash flow breakdown



f—Forecast. Capex—Capital expenditure. Source: S&P Global Ratings.

Credit metrics and financial policy

Modest revenue, EBITDA, and FOCF gains will increase the headroom for ratings, but with the exceptions of Swisscom, Cellnex, and United, we don't see metric improvement leading to positive rating momentum.

With low growth prospects and equity values, operators have scant financial flexibility to address their significant investment and shareholder return demands. Therefore, our analysis will focus on financial policy and capital allocation decisions in the next two years that will be critical as revenue growth could stall and high interest rates--which we expect to peak in 2024, but remain elevated afterward--could re-base interest costs considerably higher if leverage levels stay unchanged.

Given tighter funding conditions, we expect operators will continue to sell infrastructure assets. Tower sales have improved financial flexibility for telcos needing to deleverage, or raise funds for other uses, including investments and shareholder returns, even after lease liabilities that operators have taken on to regain access to critical tower infrastructure.

Fixed-line assets may also be sold, and often take the form of joint ventures. The motivation here has been to avoid the negative financial effects of fiber development. Deconsolidation can push capex, debt, weak initial EBITDA, and cash flow associated with an expensive greenfield fiber development off the balance sheet. However, if we think the deconsolidation may be temporary and there's the potential for reconsolidation, we may employ a proportionate approach to reflect the underlying reality--providing the distortion is material--and to avoid volatility in credit ratios arising from potential future changes in the accounting scope.

GCC telcos are actively selling their assets, as well as reshuffling their corporate structures to carve out such assets, particularly related to adjacent digital businesses, leaving the door open for future monetization. Tower infrastructure is generally owned and operated by telcos in the GCC region, with very limited independent tower operator presence. This trend may change in the next few years. In late 2022, Saudi Telecom Company (STC) received a non-binding offer from Public Investment Fund, the sovereign fund of Saudi Arabia, to acquire 51% in its fully owned tower company Tawal, valuing its more than 15,500 towers at $5.8 billion. The sale is still pending regulatory approvals. In December 2023, Ooredoo Q.P.S.C. concluded the agreement with Zain

Group and TASC Towers Holding to create the largest tower company in the Middle East and North Africa region with about 30,000 towers combined, valued at $2.2 billion. In both cases, we expect STC and Ooredoo to deconsolidate their tower operations, given the less than 50% ownership and lack of control.

GCC telcos are also developing non-telecom businesses, such as fintech, cyber security, cloud, data centers, and many others. Their businesses were either carved out or established as stand-alone entities, most recently by e&, Ooredoo, and Bahrain Telecommunications Company BSC. We expect them to grow faster than the core telecom operations, and create meaningful monetization opportunities in the future, as the GCC equity markets undergo a strong push for broadening of investable assets base and see a high number of IPOs. STC pioneered this in 2020-2021 by listing a 20% stake in its technology company, Solutions by STC, and selling a 15% stake in its licensed digital bank, STC Pay.

Key risks or opportunities around the baseline

1. Rising prices and revenues may be short-lived, opening the door to renewed competition.

We see indirect risks if poor macroeconomic conditions reduce disposable income, or if increased customer price sensitivity paves the way to aggressive price competition and higher churn rates.

2. Prolonged high interest rates that constrain access to capital markets and weaken credit ratios could punish speculative-grade issuers with more leveraged capital structures.

The sector's average debt maturity is long dated, but speculative-grade issuers with nearer-term maturities face liquidity risks if capital market access tightens. For highly leveraged issuers, for which FOCF and interest coverage are critical credit measures, higher interest rates could strain credit ratios.

3. Transaction risks exist to both the upside and downside.

Market consolidation is an upside risk if it moderates competition and improves growth prospects. Meanwhile, asset sales may weaken business profiles if strategic infrastructure is monetized, though if multiples are high enough, proceeds could provide an offsetting improvement in financial profiles.

Rising prices and revenues may be temporary, potentially reigniting competition, which remains the primary risk for the sector. Recent revenue growth, stemming from price hikes, have been digestible when inflation has raised the tide for prices on most products and services, but we don't view this a reliable long-term driver. Consistent service revenue growth has been challenging for the sector, and for Europe in particular, given high fragmentation and competition. Despite increased data traffic, which required sustained levels of relatively high operating expenditure and capex, operators haven't been able to reliably raise prices through more-for-more offers, which has led to a long-term deterioration in return on capital (see chart 27 of Appendix). If rising prices no longer drive revenue growth, aggressive operators could turn to price cuts to increase net adds and expand their market share.

Even if the revenue tailwinds from inflation persist, we think the price hikes could become untenable. Pushing all the costs to customers with reduced budgets could backfire, leading to consumer and regulatory pushback, and potentially increasing price competition by aggressive challengers. In December 2023, the U.K.'s communications regulator Ofcom proposed a new rule that would effectively ban inflation-based price indexation and require the disclosure of contractual price increases. This would increase price transparency and certainty for subscribers. Ofcom could finalize this rule in the Spring of 2024 and make it effective in the second half of the year. A backlash could also lead to government intervention and undermine any regulatory appetite for in-market consolidation and lighter-touch wholesale regulation, topics that have, or could have, relevance for several markets, including the U.K., Spain, and Italy.

A recession in Europe would ratchet up competition risks. We would expect an initial softening in the enterprise customer base resulting from reduced headcount and project spending, particularly among small- to medium-sized businesses. For retail consumers, steep drops in disposable income may not result in mass cord-cutting, but it can increase consumer price sensitivity. Customers looking for better value are more likely to churn, incentivizing low-price competition by carriers. In such a scenario, markets that we view most at risk to a flareup in competition include those with:

- An aggressive price challenger focused on growing to scale;
- A competitive market structure, typically four or more players, and a poor track record of price improvement; and
- Weak barriers to churn, including a high prepaid customer base and a low degree of convergence.

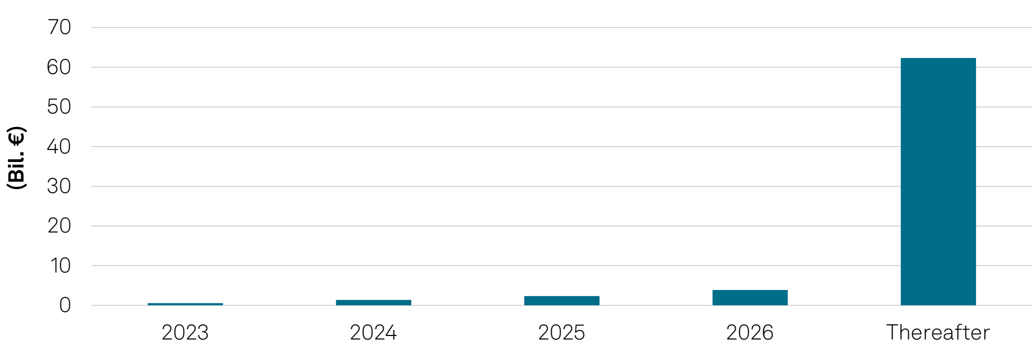
Prices and churn rates could improve in the medium term. Beyond inflation-linked price hikes, we believe upside potential exists in the medium term. As leveraged challengers refinance their capital structures at higher borrowing rates, greater debt service costs may widen cash flow shortfalls and the timeframe to break even. Among the more aggressive price players, this could force a strategic reconsideration of market exits or a shift to higher-margin, higher-ARPU offerings to shorten the time to generate cash flow. For historically competitive markets, a moderation of aggressive offers may allow prices to rise and churn rates to fall starting in 2026 as more of the maturity wall comes current.

Speculative-grade issuers with more-leveraged capital structures could take a beating from prolonged high interest rates that constrain access to capital markets and weaken credit ratios. Our first concern is for liquidity, and that speculative-grade issuers refinance opportunistically and early to avoid a maturity-driven crunch. Fortunately, most 'B' rated issuers have pushed out their maturity walls by several years during the period of ultra-low borrowing costs. With 90% of maturities now falling in 2027 and beyond, the sector has sufficient breathing room to pursue deleveraging or to refinance well in advance (see chart 16).

Chart 16

Heavily back-ended debt maturity profile buys issuers time

Single 'B' debt maturities



Source: S&P Global Ratings.

That said, debt will still mature, and our focus will be on the liquidity of issuers like Altice France (€1.5 billion of maturities in 2025), TalkTalk (€685 million in 2025), Tele Columbus (€600 million in

2025), and Telecom Italia SpA if it does not complete the spin-off of its domestic fixed-networks division NetCo from its retail division (€3.5 billion in 2024 and €2.0 billion in 2025). If debt becomes current without a defined, credible plan to address liquidity needs in the next 12 months, we will consider downgrades, including to the 'CCC' category. We could also consider taking such steps prior to the 12-month deadline if we anticipate substantial barriers to securing adequate liquidity, or if we assess a company's capital structure as unsustainable.

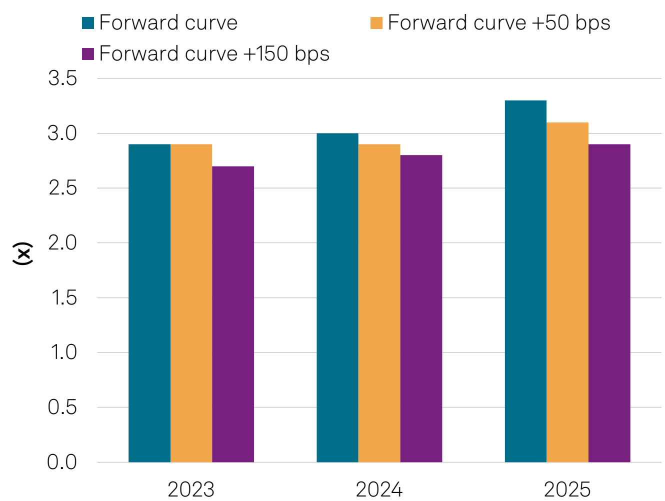
In the longer term, interest coverage and FOCF metrics--the ratios we focus on when assessing 'B' rated issuers--will weaken if they refinance at higher interest rates. However, the heavily back-ended maturity wall gives issuers time to improve their prospects, either through organic and inorganic deleveraging, or through a faster-than-expected decline in interest rates. We're therefore unlikely to reflect the impact of higher rates in our ratings until refinancings are more proximate.

In the event that rates remain high and issuers are unable to deleverage their balance sheets sufficiently, we have run stress tests to gauge the impact on interest coverage and FOCF-to-debt ratios. Although the ratios erode, the magnitude is manageable for the majority of 'B' rated issuers. For the next three years, we forecast an improvement that leaves the 2025 ratios as good or better than what we expect for 2023, even under stresses of 50 and 150 basis point increases in interest rates (see charts 17 and 18).

Chart 17

European telcos' average EBITDA interest coverage

Telcos rated in the 'B' category

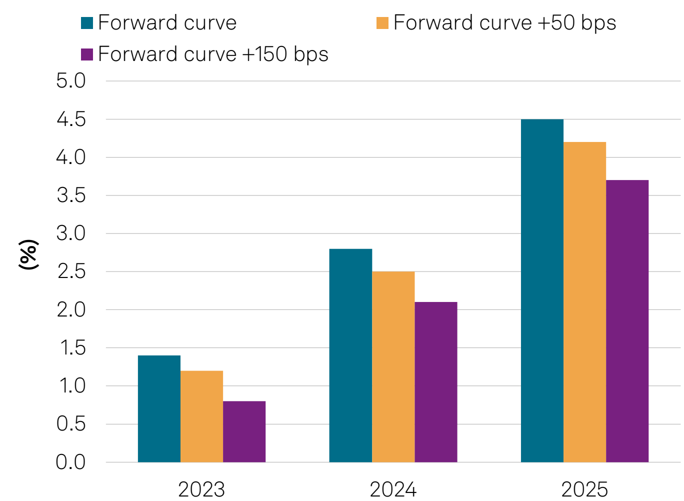


bps—Basis points. Source: S&P Global Ratings.

Chart 18

European telcos' average free operating cash flow to debt

Telcos rated in the 'B' category



bps—Basis points. Source: S&P Global Ratings.

However, for selected issuers, the stress could become considerable in the short term. Tele Columbus, for example, has already defaulted and is moving forward with a distressed exchange to recapitalize. Altice France (B-/Stable/--) faces a wider FOCF shortfall and a further delay in achieving breakeven levels. And TalkTalk (B-/Watch Neg/--) and Zacapa (B/Stable/--) are most exposed to an erosion of interest coverage to below 2x.

Transaction risks exist to both the upside and downside. Market consolidation is an upside risk if it moderates competition and improves growth prospects. Meanwhile, asset sales may weaken business profiles if strategic infrastructure is sold, though if the proceeds are high enough, they could provide an offsetting improvement in financial profiles.

M&As. European operators have long sought market consolidation to relieve competitive pressure, the key risk to telcos' credit quality, in our view. Regulators have effectively denied market consolidation for most of the past decade, with the exception of the Netherlands (a smaller market) and Italy, where steep remedies required a new and ultimately destabilizing entrant (Iliad). We view the proposed transactions in Spain and the U.K. as a test of the balance regulators are willing to strike between incentivizing investment and protecting consumers. In our opinion, the potential for approval is relatively high in Spain but will require remedies. The consolidation won't reduce infrastructure competition since it brings together MasMovil Ibercom S.A.'s asset-light entity with Orange Spain's integrated asset model. We also view the reduction in competition to be relatively modest since the incumbent is not involved and MasMovil is not a purely price-driven challenger in the market. We also expect Digi Communications N.V. will receive remedies that will allow it to scale up to shift to a mobile network operator from a mobile virtual network operator, potentially addressing consumer protection concerns. The key question is how strong a remedy package regulators will require, and whether it scuttles the deal, or cancels out the market benefits, as we saw in Italy.

In the GCC, after a few years of relative calm, telcos have resumed acquisitions. In 2023, STC's tower company Tawal acquired tower assets in Bulgaria, Croatia, and Slovenia from United Group for €1.22 billion. STC generates about 92% of revenue from its domestic market in Saudi Arabia, so expanding its geographic footprint is one if its objectives. Also, e& was very active in 2023, pursuing external growth in several markets. It announced the acquisition of a majority stake in PPF Telecom (excluding the Czech Republic operations) for €2.15 billion in Europe, its subsidiary PTCL made an offer to acquire Telenor business in Pakistan, while its $2.12 billion offer to gain a controlling stake in its 28% associate Mobily in Saudi Arabia is still pending regulatory approvals. GCC telcos deploy their capital in external growth initiatives, because their mature domestic telecom markets offer limited growth prospects. Their international subsidiaries in less mature markets demonstrate faster growth but are hampered by unfavorable currency movements. Stable regulatory frameworks and currencies in Europe offer an attractive investment opportunity for financially solid GCC telcos, which we believe will continue to expand in new markets.

Infrastructure asset sales. Telcos have steadily sold off assets since the mid-2010s, starting with mobile tower portfolios. More recently, asset sales have transitioned to fixed-network sales, fiber assets in particular, and we see risks of an adverse business impact, depending on whether the sold assets are unique and how extensive they are. For example, we view an incumbent's sale of all its fixed-network assets as likely to stress its business profile, with the downward revision in our assessment of it likely to be about one notch. The impact could be less if a challenger telco sells off its network; if the network is overbuilt by competitors and not a unique, differentiating asset; or if the operator retains other differentiating assets in the market or has diversified exposure to other markets.

To date, we have only two rated examples of a fixed-network spin-off and its business impact on the telco. One is an integrated telco Telcom New Zealand Ltd., renamed Spark New Zealand Ltd. after it split off its fixed network, which was named Chorus. The split led to a downgrade of Spark to 'A-' and a one-notch downward revision of its business risk profile to satisfactory. The other example is TDC, renamed Nuuday after it split off its fixed network, which was named TDC Net. The split led to a one-notch downward revision of Nuuday's business risk profile to fair from satisfactory.

We placed the rating on Telecom Italia on CreditWatch with positive implications while the announced sale of its fixed-line network to private-equity firm KKR awaits approval and completion. The potential deleveraging to 3.5x-4.0x could result in an upgrade to 'BB' or 'BB-'. This would also indicate a weakening of the business risk profile, similar to the case of Nuuday.

Industry Outlook: LatAm

Ratings trends and outlook

We expect generally stable ratings for LatAm operators, although about 20% of the rated issuers have a negative outlook, given weaker credit metrics due to persistently high competition, and higher inflation and operating costs. On the other hand, issuers with stable outlooks account for about 60% of the region's rated industry entities thanks to robust demand for data usage, operating efficiencies, and strong balance sheets that provide the leverage headroom to absorb weaker economic conditions. Positive outlooks mainly reflect a similar rating action on the sovereign rating on Brazil. We also continue to view growth prospects for tower companies in the region as favorable, as under-penetration remains a driver for the expansion of their respective networks, compared to more developed regions.

Main assumptions about 2024 and beyond

1. Modest revenue growth and limited profitability.

We expect revenues to remain moderate, in line with our forecast for a low trend for GDP growth across LatAm in 2024.

2. No major regulatory changes expected.

We don't anticipate regulatory risks related to spectrum license cancellations or paused renewals that would impede technological advances in the industry.

3. Divestments of fiber and tower assets continue.

Carriers have taken strategic initiatives to accelerate growth, and some of them have spun off their fiber and tower businesses mainly to reduce capex and leverage.

Modest revenue growth and limited profitability. Overall, we anticipate moderate growth among LatAm operators. We expect the industry growth to be in low-single digits for 2024, reflecting a similar economic growth trend for the region. On the one hand, we believe revenue growth for smaller players will be low as operators maintain promotional packages to regain market share, denting ARPUs as well as operating margins that have been below 20%. On the other hand, we expect larger players in Brazil and Mexico--Telefonica, Algar Telecom S.A., and America Movil S.A.B. de C.V.--will continue to grow. These companies are focusing on bundled products, including mobile and broadband (fiber) and increasing value-added services, taking advantage of the realized investments for the 5G spectrum. As a result, we expect steady revenue growth as demand for data services increases, coupled with strong operating performance and EBITDA margins above 30%.

No major regulatory changes in 2024. Although carriers are subject to extensive government regulation and could stress their operations, we don't anticipate significant changes in this regard. Actually, governments in the region are contributing to the industry's growth by not restricting spectrum bids and limiting the rises in taxes on the industry.

In Chile, Brazil, and Colombia, there are no relevant changes on the regulatory front. Yet in Mexico, the Federal Telecommunications Institute (the industry regulator) is currently working on its biannual revision of the asymmetric regulation applied to America Movil in 2013, to determine if sufficient competition in the telecom sector exists. Although we don't expect any additional measures or changes, we will closely monitor the result of this revision and its impact on the company's business and financial performance.

Divestments of fiber and tower assets continue. LatAm companies have been moving toward the separation between services and infrastructure services, reducing the investment burden stemming from constant network upgrades. Telefonica and Claro S.A. have sold these assets to develop targeted financial plans and capital allocation to foster growth and strengthen their competitive positions. America Movil (Claro) already completed the spin-off of all of its tower companies in LatinAm, creating two new companies--Operadora de Sites Mexicanos S.A.B. de C.V. and Sitios Latinoamerica S.A.B. de C.V. During 2023 the spin-off of the towers business in Austria Telekom, one of its subsidiaries, was also completed. Additionally, Telefonica (Coltel) received cash for its infrastructure assets in Colombia, Peru, and Chile. These transactions have helped companies reduce debt obligations and strengthen their financial position, but the proceeds also have a significant impact on reducing capital investments requirements going forward.

Credit metrics and financial policy

For Chilean and Colombian operators, we expect EBITDA margins to remain below the industry average, resulting from significant competition and weak operating performance taking a toll on leverage metrics and liquidity. We also anticipate cash flow will remain pressured due to high capital requirements to continue increasing network capacity and quality to improve customer loyalty. Likewise, we expect to see lower dividend payments and some capital contributions in attempts to strengthen balance sheets.

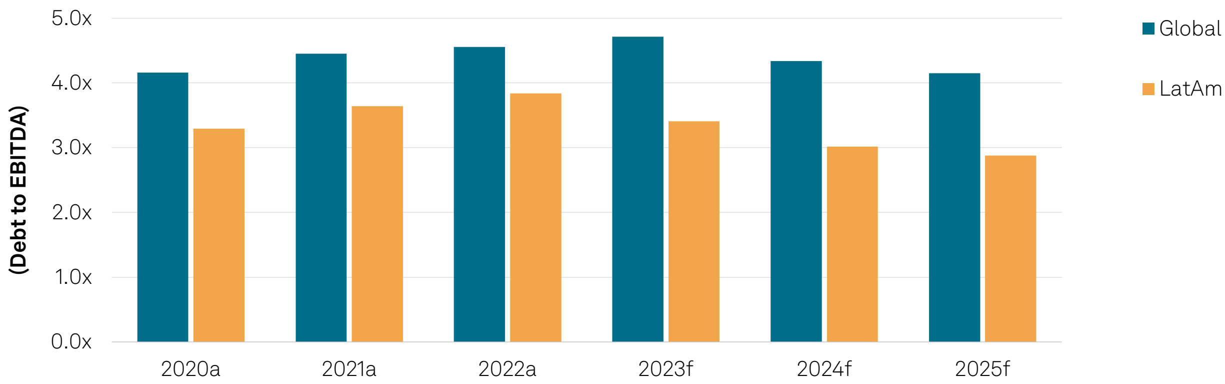
However, we expect the leading players will continue with the deployment of 5G technology. We also expect companies will continue to focus on coverage to enhance their value-added services to boost data usage and revenue growth, minimizing leverage concerns.

We believe tower companies' profitability will benefit from high cash-flow predictability, while the substitution risk remains low, in line with built-to-suit sites, price inflation-linked escalators, and an overall long-term average maturity of contracts. While the expansion will continue to require sizable investments, we expect companies to continue to access bank and market debt funding as their optimal capital structures allow for relatively higher leverage than for other subsectors within the telecom industry. At the same time, this should allow companies to continue to benefit from inorganic growth if opportunities from carrier spin-offs or market consolidation materialize in the short to medium term.

In Brazil, we expect M&As to increase in 2024 as interest rates fall and demand for broadband services start to rise again. During 2023, Vero S.A. and Americanet ltda. (Brazilian internet services providers [ISPs]) announced a business combination, creating the country's second-largest independent ISP.

Chart 19

Debt to EBITDA (average, adjusted)



a—Actual. f—Forecast. Source: S&P Global Ratings.

Key risks or opportunities around the baseline

1. Competition remains stiff.

The entrance of new carriers with aggressive price strategies continues to increase competition, creating market destabilization in some LatAm countries.

2. Intense capital needs to develop new technologies.

Companies will need to increase their investments to continue increasing network capacity and quality and to improve customer loyalty.

3. High interest rates and inflation could weigh on telecom companies.

Telcos are struggling with the currently tough macroeconomic conditions, making it difficult to maintain high EBITDA margins.

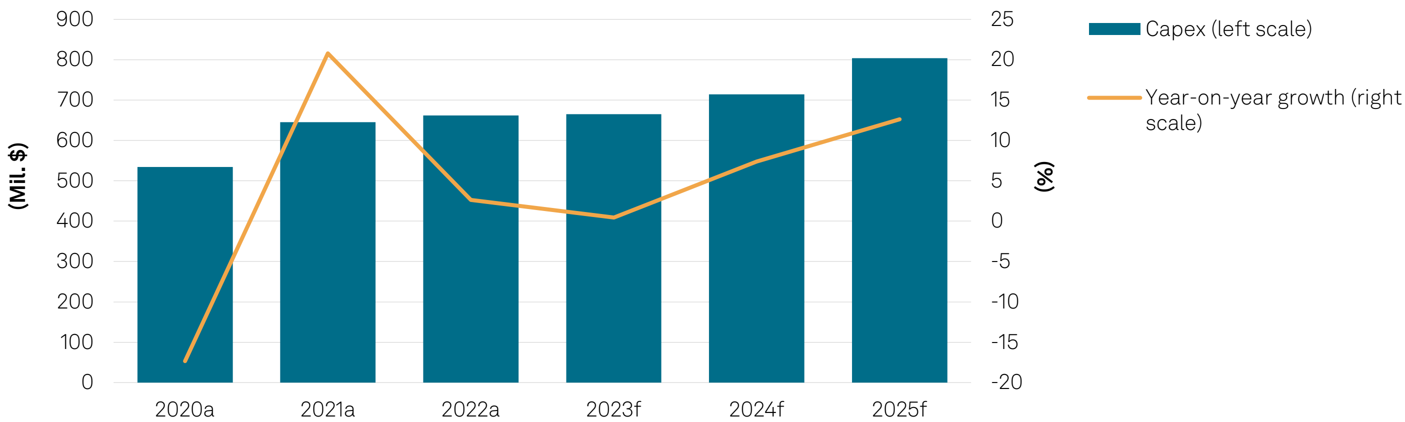
Competition remains a risk. Chile and Colombia are good examples of highly competitive environment following the entrance of Wom S.A., which seeks to become a large player in those markets. This has resulted in increasing customer churn and weakening in ARPUs. Most carriers still want to keep low service prices to maintain market share; however, this could dent profitability and cash flow, leading to higher leverage and delays in the improvement of credit metrics. Meanwhile, VTR Finance N.V. has experienced a sharp deterioration of its brand and customer satisfaction, and a drop in subscribers, revenue, EBITDA, and cash flow as a result of intense operating pressures and competition from its peers with better fiber option networks. Also, the persistently high competition in the Chilean market, coupled with weaker macroeconomic conditions, has eroded Telefonica Moviles Chile S.A.'s ARPUs and margins, weakening profitability and leverage metrics.

Investments will increase for the 5G deployment (see chart 20). In order to maintain low churn rates and good market positions, LatAm carriers focus on raising the quality of their networks by increasing coverage, quality, and speed of services. We have seen greater focus on investments in the FTTH deployment and in the 5G technology. However, most governments in the region have been focusing on getting coverage to areas that still don't have access to telecom services, as well as completing the transition from copper to fiber. These priorities have delayed the 5G spectrum license bids and haven't contributed to the investments needed for 5G infrastructure assets.

In Brazil, ISPs are still implementing the 5G coverage. Brisanet Servicos De Telecomunicacoes Ltda and Unifique Telecomunicações S.A. have started to offer these services by using capacity at their existing towers.

Chart 20

Capex growth in LatAm



a—Actual. f—Forecast. Source: S&P Global Ratings.

High interest rates and inflation could dent telcos' performance. They have already taken a toll on profitability, cash flow, and leverage metrics of the main operators. Companies have compensated for these effects by delaying investments, aggressive reductions in operating costs, or taking on additional debt.

In Chile, higher costs of capital pushed telcos to sell fiber assets and lease them back, which comes at the expense of weaker profitability. We expect more asset sales to come during the next few months, which would provide a temporary relief to liquidity but would stress margins, so we expect operators to work on their cost structures to diminish the burden.

Industry Outlook: APAC

Ratings trends and outlook

Telcos navigate cost pressure and limited returns from 5G investments. Our base-case scenario assumes a moderate earnings growth, spurred largely by increasing mobile data traffic. In some South and Southeast Asian markets, where there's saturation in the mobile market and high price sensitivity, we see fixed broadband as a bright spot in telcos' earnings as adoption grows. Uptake rates of 5G in many APAC markets remain too low to boost overall ARPU, while rising labor and electricity costs threaten to squeeze margins. Cost-cutting initiatives are therefore a common theme among APAC telcos to preserve margins.

The net rating bias for APAC telcos is now mildly negative. This is an improvement from a negative bias of over 30% around 2019 and 2020. Divestment-driven deleveraging underpins this improvement. For example, we upgraded Voyage Digital (NZ) Ltd. in 2023 given its debt reduction, which was made possible by its telecom tower sale. Similar actions by other telcos, while not having resulted in positive rating actions, increased their rating cushion. We believe such divestments are driven by the need to create balance-sheet capacity for incremental 5G investments and for building new revenue streams further from traditional telco services to boost long-term earnings potential. We expect such divestments to continue, and that telcos will move from selling towers to other passive infrastructure and non-core assets.

Negative rating actions, if any, will likely be driven by idiosyncratic factors. The first wave of 5G capex is over for APAC telcos, easing pressure on balance sheets. But as returns from such investments remain limited, telcos may explore M&As to accelerate growth, gain market share, and reduce competitive pressures. Such transactions, if debt-funded, can weaken credit quality. Sporadic and expensive 5G spectrum auctions could also raise leverage stress.

On the earnings front, telcos with exposure to emerging markets may experience squeeze from currency depreciation. This is especially prevalent among South and Southeast Asia telcos.

Main assumptions about 2024 and beyond

1. Moderately rising earnings as telcos navigate cost pressures.

EBITDA of APAC telcos will, on average, rise by a mid-single digits starting in 2024 thanks to increased mobile data traffic and fixed broadband adoption. Telcos are adopting cost-cutting initiatives and simplifying business structures to mitigate the impact of higher electricity and labor costs on margins.

2. Capex intensity should ease as telcos continue 5G investments cautiously.

While 5G investments are necessary for competitive parity, telcos will focus network spending on pockets with higher demand to maximize returns. We expect the average capex intensity (average of telcos' capex-to-revenue ratios) to be 21% in 2024, down from an estimated 23% in 2023.

3. Telcos will divest to invest.

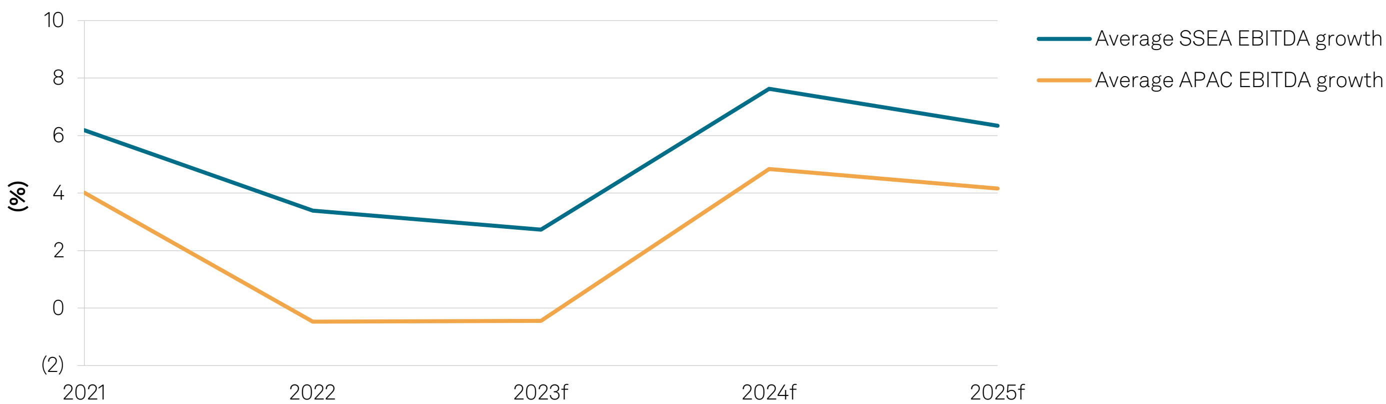
While telecom tower sales were in vogue in the past 36 months, we believe telcos will move to selling other infrastructure and non-core assets. There's also some initial momentum in bringing in strategic partners for new growth engines.

Earnings will rise moderately, benefiting from rising connectivity demand and cost-cutting measures. Demand for faster and more data will spur upgrades to higher-priced mobile rate plans. This could be for migration to more advanced networks for faster speeds, or for more data allowances.

Our base-case scenario shows a divergence in the extent of earnings growth that we expect. We forecast earnings of telcos in more mature markets such as Korea, Japan, and New Zealand to increase by a low-single digits. In contrast, projected earnings growth for telcos in less mature markets, particularly in South and Southeast Asia (SSEA), generally lean toward the mid- to high-single digit range. On average, we expect EBITDA of APAC telcos will be up by mid-single digits in 2024 (see chart 21).

Chart 21

APAC telcos' EBITDA to rise by mid-single digit annually on average



Note: Excluded Axiata Group Bhd., Advanced Info Service Public Co. Ltd., Voyage Australia Pty. Ltd., and Voyage Digital (NZ) Ltd. due to merger and acquisition activities. f—Forecast. Source: S&P Global Ratings.

The rising uptake of fixed-line broadband will remain a bright spot for several APAC markets. Fixed-line broadband is growing rapidly in markets such as Thailand and the Philippines, where the penetration rate remains low with about half or less of households having such connections.

ARPU and earnings will benefit from 5G services, even though not all telcos are charging a premium for 5G services. Data use typically rises with migration to 5G, even though the use of 5G service in and of itself doesn't consume more data. But it enables more data-heavy options, such as superior video streaming. This better user experience could, in turn, encourage more consumption and drive upgrades to higher-priced plans that offer more data. That said, more obvious benefits of the 5G migration could take longer to observe, as adoption rates remain too low to boost overall ARPU substantially. The effects may also be masked by an ongoing decline in ARPU that we have observed in many APAC markets.

The viability of fixed-wireless broadband as an alternative to fixed-line broadband is raised by 5G. This can boost earnings of telcos in markets such as Australia and New Zealand, as fixed-wireless broadband allows them to bypass low-margin reselling of national fixed-broadband networks.

The rated tower companies in India and Indonesia should benefit from demand for more towers and colocation to accommodate rising data traffic. A denser tower network is especially needed for telcos that adopt stand-alone 5G. This is to compensate for the weaker penetrative ability of the high-band 5G signals used.

APAC telcos must navigate inflation-linked rising costs, with little ability to pass them on to consumers. This is because it is rare for prices of mobile plans in APAC to be linked to the CPI, unlike in markets such as northern Europe. Among APAC telco markets that we analyze, we only see CPI-linked mobile plans in Australia. Cost-cutting measures are thus commonplace and will blunt the fallout from higher costs.

Average capex intensity should ease as telcos continue 5G investments cautiously (see chart 22). The first wave of high 5G spending has passed among the rated APAC telcos, with Bharti Airtel Ltd. as among the last ones to roll out 5G networks since late 2022. APAC telcos have found it difficult to resist investing in 5G despite limited monetizable opportunities. They need to offer 5G, even for limited consumer use cases, to retain competitive parity at least.

We expect telcos to improve their 5G network quality based on adoption rates and the success of 5G industrial use cases. This could mean strengthening 5G coverage in dense cities and central business districts, ahead of less populated areas.

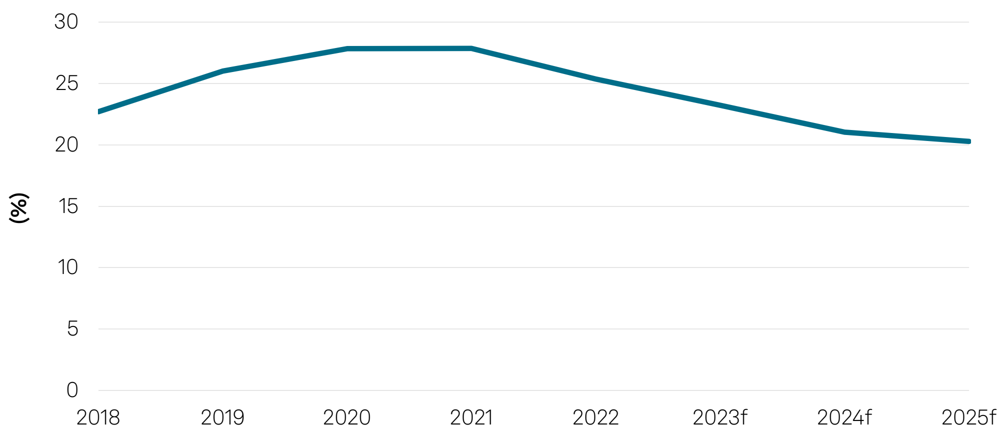
At the same time, investments to enhance fiber networks in several APAC markets have also slowed. For example, the Philippines-based PLDT Inc. completed its copper-to-fiber migration in 2023, while New Zealand-based Chorus Ltd. completed it in 2022.

As a result, we project the average capex-to-revenue ratio for rated APAC telcos to ease to 20%-21% in 2024 and 2025 from an estimated 23% in 2023.

Chart 22

APAC telcos' capex intensity to further ease

Average capex-to-revenue ratio



Note: Excluded Summit Digitel Infrastructure Ltd. because of its exceptionally high capex intensity at inception in 2019. f—Forecast. Source: S&P Global Ratings.

Telcos will sell non-core and passive assets to create balance-sheet capacity. Transactions involving APAC telcos selling tower assets should slow, after a spate of them in the past 36 months. Such transactions have increased telcos' financial flexibility. We believe telcos will move toward divesting other business and infrastructure assets. We see early signs of this as some telcos restructure their businesses, which could facilitate subsequent divestments. Proceeds from selling assets that are not key to the telcos' competitiveness can create funding capacity for capex and investments in new growth engines.

APAC telcos will be strategic about their ownership of assets, in our view. For investments not central to their competitive advantage, we expect telcos will sell them entirely or in part. For example, Singapore Telecommunications Ltd. announced its intention in May 2023 to undertake S$6 billion of capital recycling in the medium term. Thus far, this has included a partial divestment of the building that houses its headquarters, as well as the sale of its cyber-security arm.

Hong Kong Telecommunications (HKT) Ltd. and its parent PCCW Ltd. have also been divesting businesses since 2021. This includes data centers in December 2021, a majority stake of PCCW's solutions business in August 2022, and a significant minority stake in its video-streaming business in June 2023.

Some partial divestments will be to strategic partners, particularly for new growth engines in areas further from telcos' core connectivity business, where telcos may bring in partners to reduce exposure to execution risks. Such partial divestments can also reduce the strain on leverage.

Telcos will be more hesitant to sell active infrastructure assets. In our view, this may be because such assets can help telcos capture the demand and earnings potential from growing adoption of cloud services and artificial intelligence. For example, Australia-based Telstra Group Ltd. publicly stated in August 2023 its intention to retain ownership of its infrastructure arm InfraCo Fixed for the medium term. This announcement came less than a year after Telstra completed the structural separation of its businesses into discrete units, intended to provide more flexibility to explore growth and monetization options.

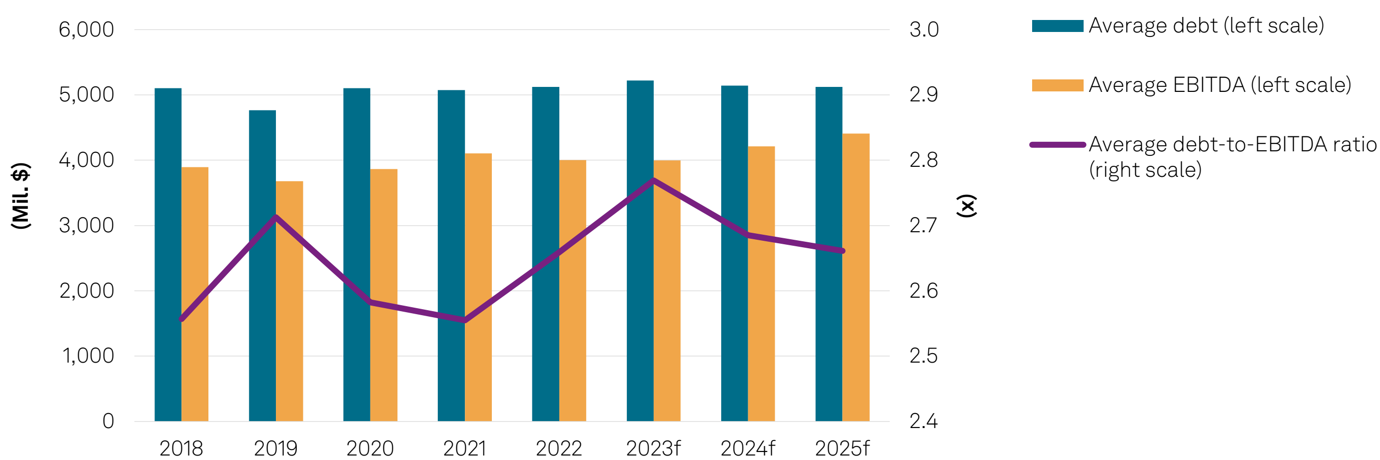
If telcos were to sell active infrastructure assets, it could weigh on their business strength. In our view, such assets could confer competitive advantage on telcos, especially if they're extensive or unique to the telco. In determining the implications for the telcos' credit profiles, we will consider, among other factors, the extent to which the assets drive their competitive advantage, the level of control retained in these assets, and any change to leverage.

Credit metrics and financial policy

Upward rating momentum is unlikely despite a moderate rise in earnings. While we expect earnings to rise by mid-single digits on average, metric improvement will be incremental at best. We estimate the average debt-to-EBITDA ratio of APAC telcos to be 2.6x-2.7x in 2024 and 2025, compared with an estimated 2.8x in 2023 (see chart 23). That's because continued investments in 5G and new growth engines will use up balance-sheet capacity.

Chart 23

APAC telcos' leverage to remain largely stable



Note: Excluded Nippon Telegraph and Telephone Corp., PT. Profesional Telekomunikasi Indonesia, Summit Digitel Infrastructure Ltd., and Voyage Digital (NZ) Ltd. due to acquisition-led debt increases or high inception leverage. f—Forecast. Source: S&P Global Ratings.

APAC telcos should tolerate higher interest rates well. The predominantly investment-grade nature of the rated APAC telcos has meant that the heightened interest-rates haven't eroded credit metrics. Most APAC telcos have well-distributed debt maturities and a sizable proportion of fixed-rate debt. In addition, some telcos like China Mobile Ltd. and Taiwan-based Chunghwa Telecom Co. Ltd. have no debt on a net basis. Persistently low interest rates in Japan also benefit the domestic telcos, at least with regard to their borrowing costs.

Leverage management remains crucial. With investments in 5G and new growth engines continuing, while returns lag, telcos must work harder to keep their balance sheets lean. With the rated APAC telcos mostly at investment grade, the focus is on financial policy. We believe that timely asset divestments to cope with ongoing capex will be the key tool telcos will use to preserve their credit metrics.

Key risks or opportunities around the baseline

1. Competition, prolonged inflation, and currency risks could weigh on earnings.

Operators in markets with new entrants could adopt more cautious pricing. Prolonged inflationary pressures could result in slower upgrades to higher-priced plans and new 5G-enabled handsets. This, coupled with cost pressures, could be a drag on margins. Telcos with exposure to emerging markets with weakened currencies could face slimmer earnings.

2. A need for more capex.

Telcos that have rolled out non-stand-alone 5G may face another investment wave as they move toward stand-alone 5G. Sporadic spectrum buys could also exacerbate leverage stress.

3. Rising investments in new growth engines could raise the earnings potential, but also leverage.

APAC telcos have been investing in new growth engines, particularly in data centers, to boost growth. Such investments, if debt-funded, can erode the rating headroom. Execution risks could also lead to higher-than-expected capital intensity.

Competition and macroeconomic factors could limit earnings upside. Consolidation (both ongoing and concluded) in markets such as Thailand, Indonesia, Malaysia, and Taiwan will likely result in stronger players, more rational pricing, and lower the risk of a new player entering into the market. In contrast, operators in markets with new entrants, such as in the Philippines, or those with growing mobile network operators, such as in Korea, could adopt more cautious pricing.

Prolonged inflationary pressure, other than weighing on telcos' cost structures, can also weaken consumer sentiment. This could result in slower upgrades to higher-priced plans and lengthen handset replacement cycles, especially in price-sensitive and predominantly prepaid markets.

Telcos such as Axiata Group Bhd. and Bharti Airtel Ltd. are more exposed than others to currency-depreciation risks. This is given their exposure to emerging markets such as Sri Lanka and Africa, where domestic currencies have weakened substantially. In addition, regulatory risks are higher in emerging markets. We believe high regulatory risks contributed to Axiata's exit from its Nepalese telco operations, which it announced in December 2023.

Capex risks diverge for APAC telcos. This is because the scale of costs for 5G spectrums is wide, ranging from no upfront fees for telcos in countries such as China and the Philippines, to more than US$5 billion for telcos in India. Sporadic spectrum auctions in countries where spectrum licenses are expensive, such as in Taiwan, Thailand, and India, pose as an event risk. This is especially so when the timing of such auctions remains uncertain.

Another wave of 5G spending could also come for telcos that have adopted the non-stand-alone 5G model, as they move toward a stand-alone model eventually. We believe that most, if not all, operators will do so to capture more meaningful monetization benefits. Stand-alone 5G can provide faster speeds, much lower latency, as well as the ability to slice networks. Network slicing is imperative to tailor networks to the needs of consumers and businesses in industrial-use cases.

Investments in new growth engines could weigh on leverage due to lag in payback. APAC telcos' investments into new growth engines have been on a rise, in a bid to boost the long-term earnings potential. Such investments, if debt-funded, can diminish the rating headroom, because these new revenue streams take time to ramp up.

As telcos move away from the traditional core-connectivity business, they may lack the know-how and execution risks could arise.

Related Research

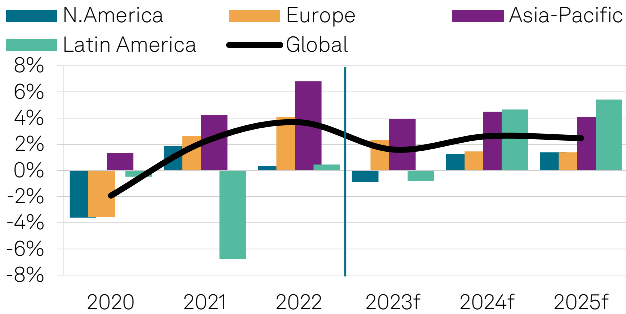
- Credit FAQ: What's On European Telecoms Investors' Minds?, Dec. 14, 2023
- Price Dynamics And Ability To Invest In New Technology Will Determine The Path Ahead For Latin American Telecom Companies, Oct. 5, 2023
- Credit FAQ: The Evolving Landscape Facing U.S. Cable Operators, Sept. 26, 2023
- Credit FAQ: Intense Competition And Investments Eat Into Chilean Telecom Operators' Metrics Amid Efforts To Bolster Returns, Aug. 11, 2023
- Asia-Pacific 5G: Telcos Face A Billion-Dollar Balancing Act, July 24, 2023
- Credit FAQ: U.S. Telecoms Face New Credit Risks From Old Cables, July 19, 2023

Industry Forecasts

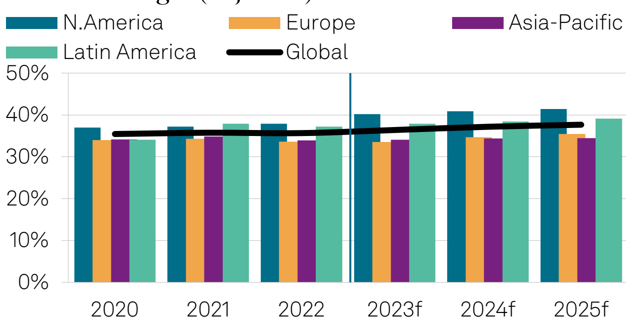
Telecoms - Fixed and Wireless

Chart 24

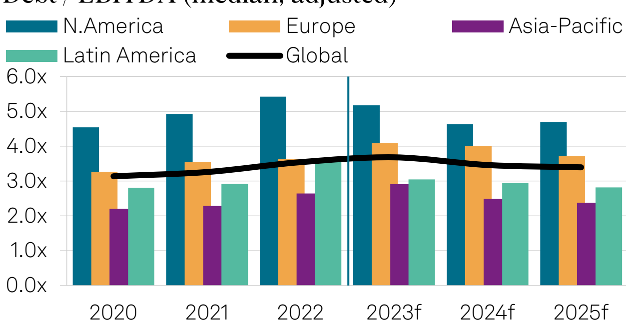
a) Revenue growth (local currency)



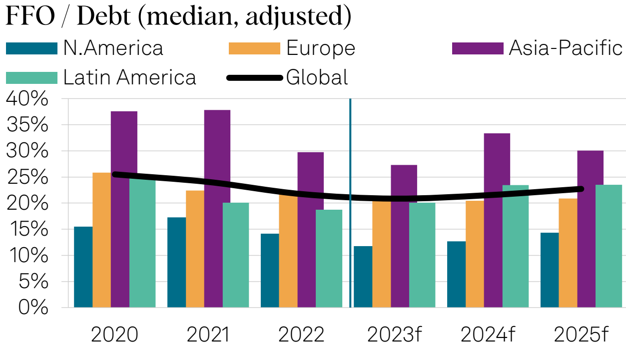
b) EBITDA margin (adjusted)



c) Debt / EBITDA (median, adjusted)



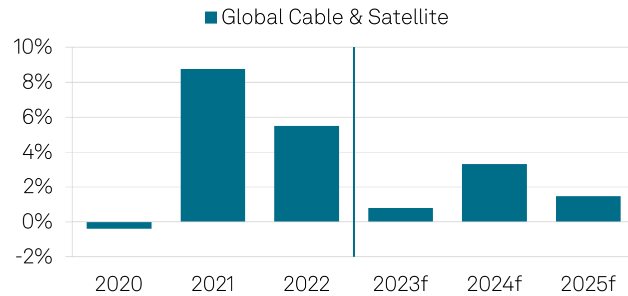
d) FFO / Debt (median, adjusted)



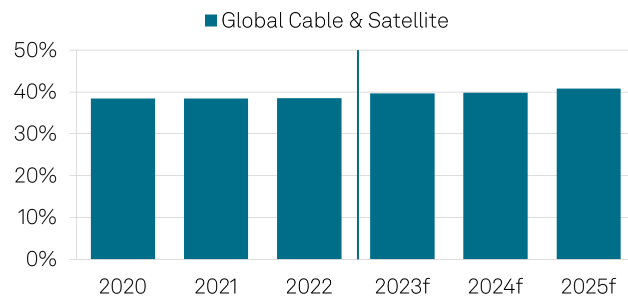
Cable and Satellite

Chart 25

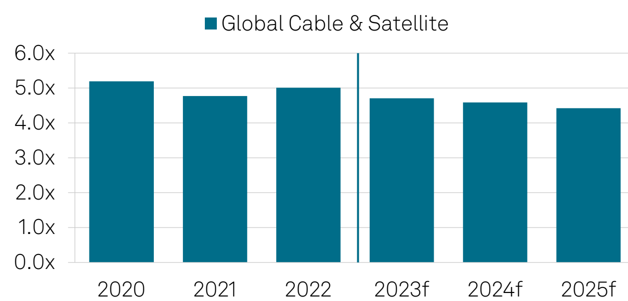
a) Revenue growth (local currency)



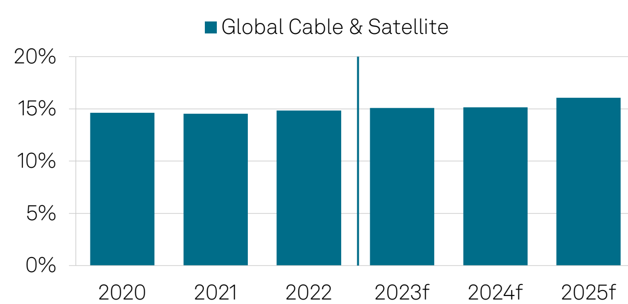
b) EBITDA margin (adjusted)



c) Debt / EBITDA (median, adjusted)



d) FFO / Debt (median, adjusted)



Source: S&P Global Ratings. f = Forecast.
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. FFO—Funds from operations.

Cash, Debt, And Returns: Telecoms

Chart 26

Cash flow and primary uses

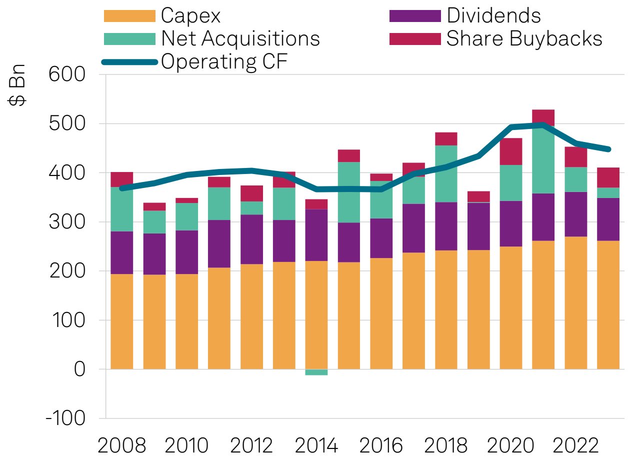


Chart 27

Return on capital employed

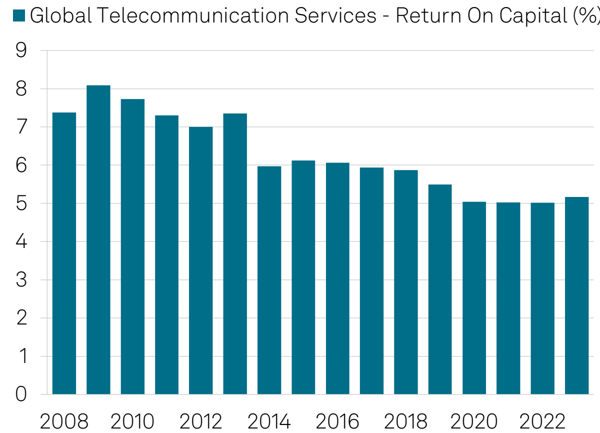


Chart 28

Fixed- versus variable-rate exposure

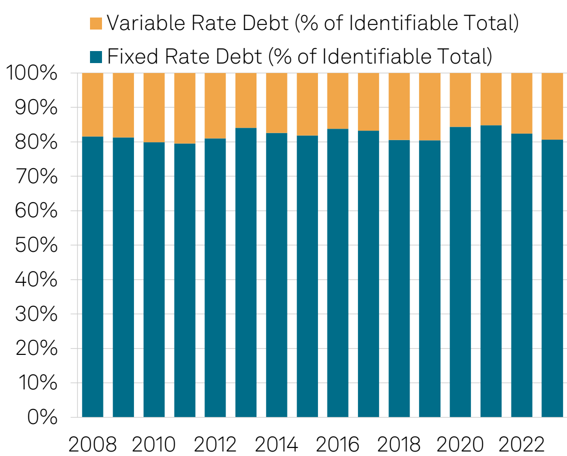


Chart 29

Long-term debt term structure

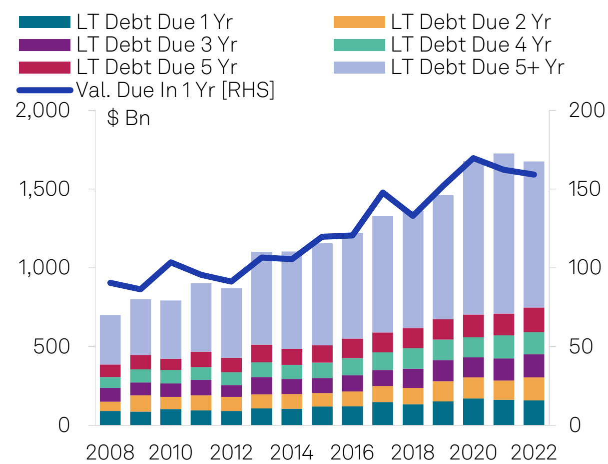


Chart 30

Cash and equivalents / Total assets

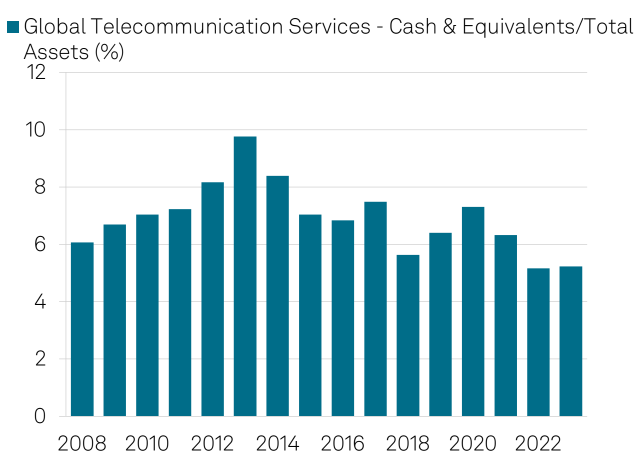
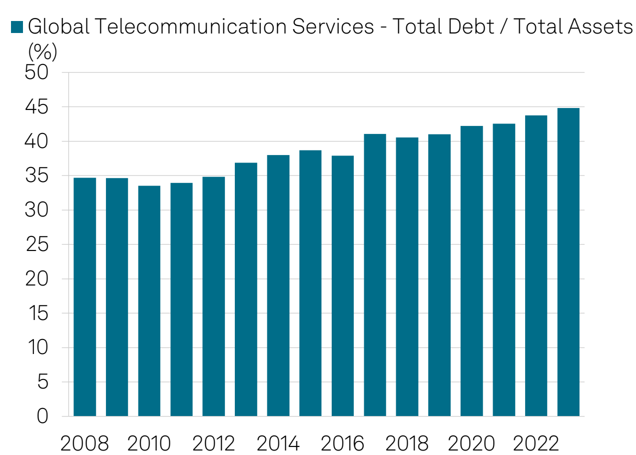


Chart 31

Total debt / Total assets



Source: S&P Capital IQ, S&P Global Ratings calculations. Most recent (2023) figures use the last 12 months' data.