

# Industry Top Trends 2019

## Telecommunications

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### Key Takeaways

- **Ratings Outlook:** Ratings should remain largely stable through 2019, although the global rating outlook bias has been trending negative in recent years. We attribute this change to weaker balance sheets, as well as structural and competitive factors in maturing markets, especially the U.S. Notably, Western Europe has become somewhat more negative over the past year, with M&A activity and shifting currency values contributing to our expectation of more leveraged balance sheets. Latin America continues to have a negative outlook bias of around 20%, but the trend there has improved over the past year, reflecting our expectations of a more favorable operating environment, predominantly stemming from steady growth in data usage that is supported by strengthening economies.
- **Forecasts:** We forecast global telecom revenue growth of 2%-3% through 2019 driven primarily by broadband as demand for high speed data continues to increase. Overall, we expect relatively stable credit metrics with adjusted debt to EBITDA averaging around 3x-3.5x for global fixed and wireless players through 2020 and about 4x for cable companies with more predictable cash flow.
- **Assumptions:** We expect consumers to continue to demand faster and more reliable internet connections as video becomes more embedded in social media applications and consumers increasingly watch TV online. We expect carriers to continue to invest in their infrastructure to improve the user experience and maintain, or attempt to grow, market share.
- **Risks:** Risks in the telecom and cable sector include intense competition, accelerating cord-cutting trends in fixed-line voice and video, and the high levels of capital needed to support ongoing demand for data. Price competition and financial policy risk remain key factors in Europe, while political risk is particularly prominent in the Middle East.
- **Industry Trends:** As providers contend with mature industry conditions and aggressive competition, they are questioning whether 5G wireless technology investment will boost top line growth and profitability or drain cash flow as they bid for new spectrum licenses and invest in network infrastructure.

# Ratings trends and outlook

## Global Telecommunications

Chart 1

Ratings distribution

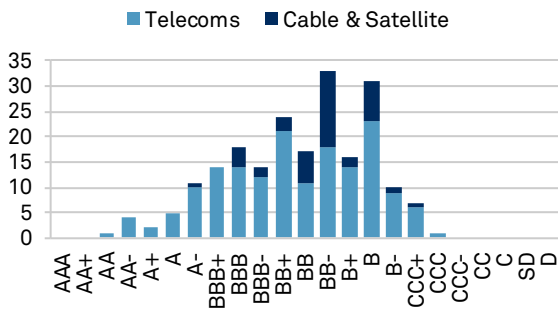


Chart 2

Ratings distribution by region

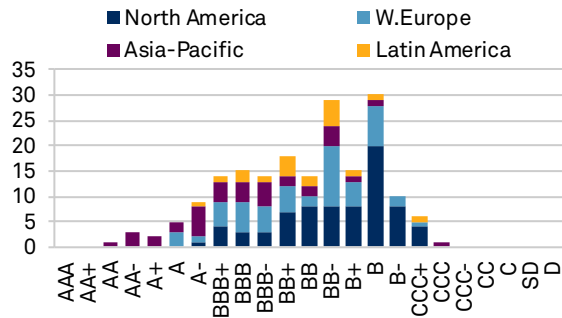


Chart 3

Ratings outlooks

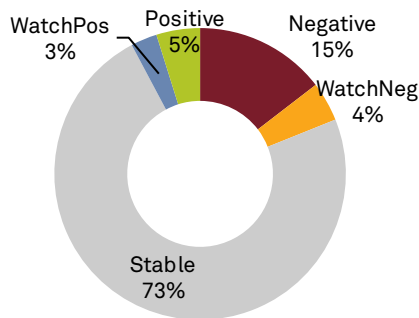


Chart 4

Ratings outlooks by region

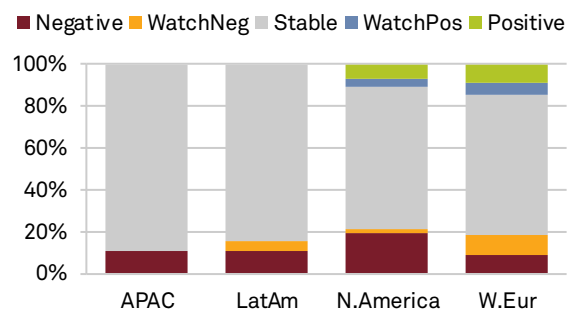


Chart 5

Ratings outlook net bias

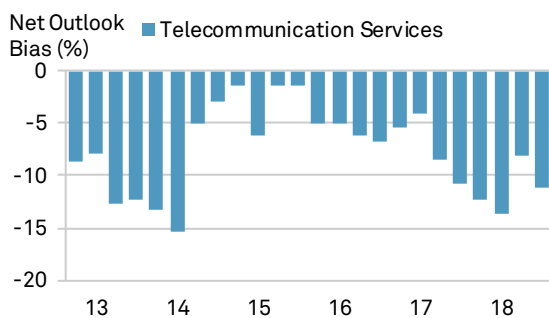
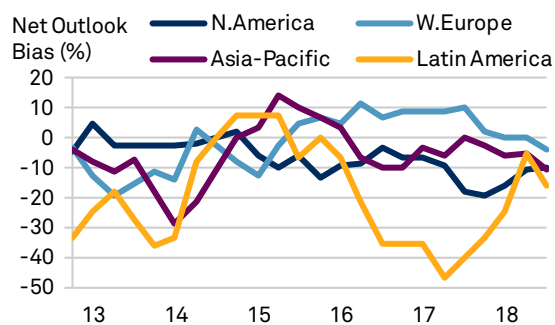


Chart 6

Ratings net outlook bias by region



Source: S&P Global Ratings. Ratings data measured quarterly with last shown quarter ending September 30, 2018

Overall, we expect broadly stable ratings over the next year, though we are currently reviewing our ratings on global satellite operators amidst our view of weakening industry fundamentals and technology-led oversupply risks. We believe, in particular, that fixed and mobile satellite services may be adversely affected by the newest, faster, and higher capacity high-throughput satellite technology, which is resulting in oversupply of capacity and increased pricing pressure. We are mindful of rapid growth in adjacent satellite services for aircraft and ships, but think this could prove insufficient to offset the effects of the supply and demand mismatch.

## North America

We expect broadly stable ratings, though approximately 20% of rated issuers have a negative outlook primarily because of secular declines in wireline amidst leveraged balance sheets. We expect pay-TV declines to continue to affect satellite TV providers the most because they lack a natural broadband hedge. Continued M&A in the U.S. because of a more supportive regulatory environment could also pressure ratings, depending on financing plans. Modest earnings growth and stabilizing capital intensity will support ratings stability in Canada, although upcoming wireless spectrum investments and shareholder policies could drive some variation.

## Europe and Middle East

We expect stable ratings in Europe. The outlook bias, however, has turned negative for the first time in three years, due in part to leverage pressure from M&A. Nevertheless, Europe still retains a more balanced mix of outlooks than other regions. An aggressive pursuit of cost savings should marginally improve leverage headroom, despite intense competition and stagnant pricing. We have a stable outlook for cable ratings as well. However, topline and EBITDA growth is slowing into the low-single-digit percentage range, and we think free cash flow will be increasingly consumed by expanded capital spending budgets, aggressive shareholder returns, and M&A activity.

In the Middle East, ratings are largely driven by sovereign factors. For example, most GCC telecoms (with the exception of Qatar's Ooredoo and the UAE's Etisalat) are currently constrained by their sovereign ratings, and both Turkish operators are capped by their country's T&C assessment.

## Latin America

The rating bias on LatAm issuers has improved significantly since last year. The region had faced a high negative bias of about 35%, reflecting somewhat high debt leverage, a highly competitive environment, a slow economic recovery that limits the near-term growth prospects of these issuers, and the negative outlook on Brazil's sovereign rating. This year, however, our rating bias has come down to about 20%, reflecting our expectations of a more favorable operating environment across the region, predominantly stemming from steady growth in data usage that is supported by strengthening economies. The CreditWatch Negative listing for an Argentine telecom operator is explained by the CreditWatch Negative listing of Argentina's sovereign rating.

## Asia Pacific

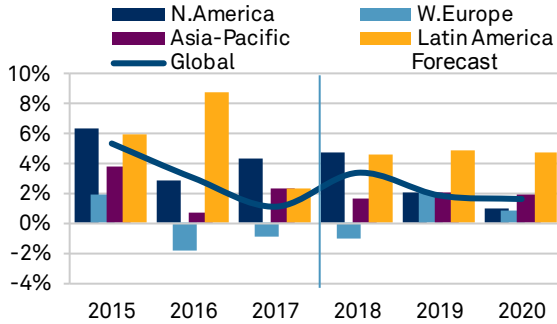
We expect generally stable ratings for Asia-Pacific telecom operators because steady regional GDP growth and growing mobile data usage will support their overall credit quality. However, we see intensifying competition in India, Indonesia, Australia, Singapore, and Taiwan, with ongoing large capital investment required for advanced networks including spectrum. This is the major reason for the net negative outlook (-11%) in APAC.

# Industry forecasts

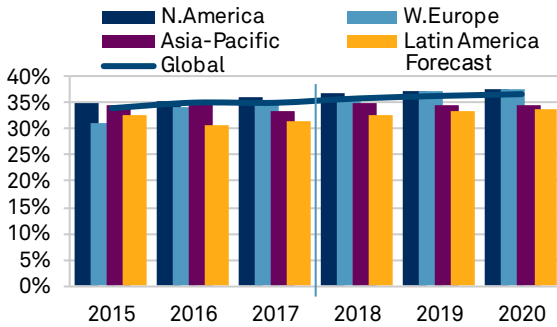
## Telecommunications – Fixed and Wireless

Chart 7

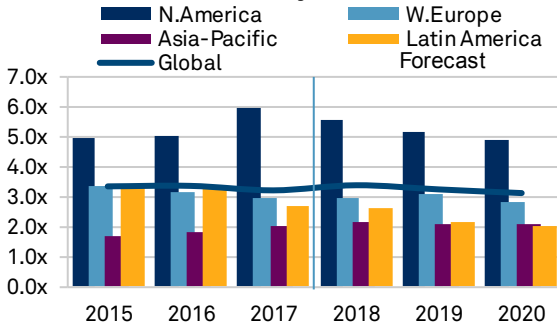
### Revenue growth (local currency)



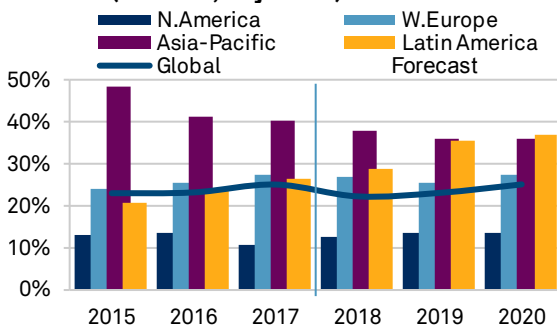
### EBITDA margin (adjusted)



### Debt / EBITDA (median, adjusted)



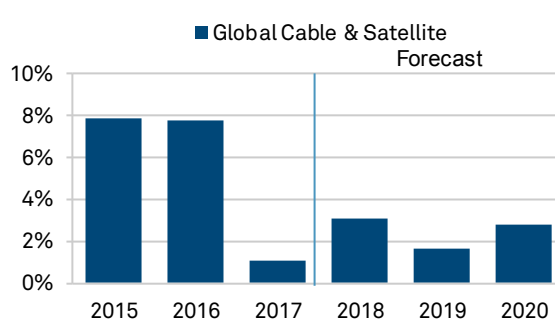
### FFO / Debt (median, adjusted)



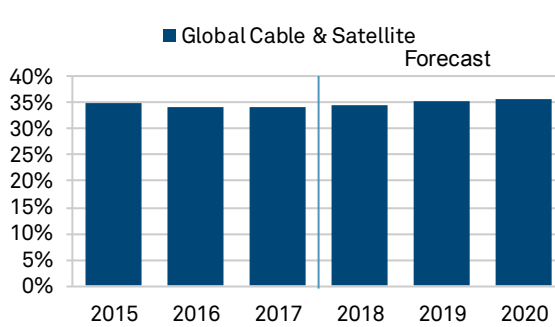
## Cable and Satellite

Chart 8

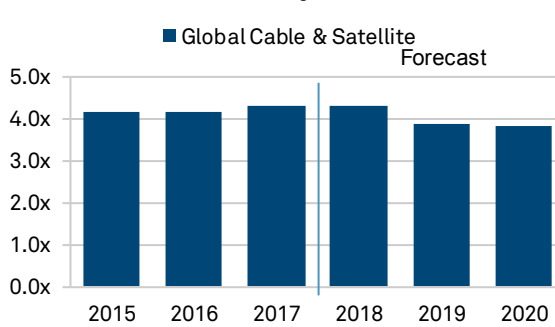
### Revenue growth (local currency)



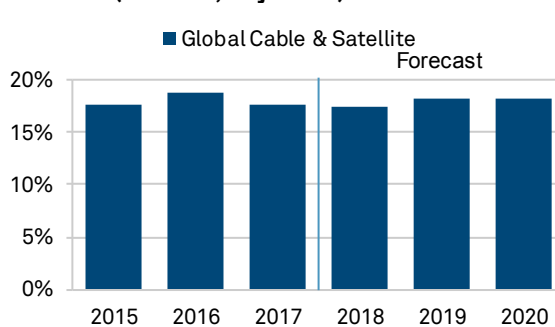
### EBITDA margin (adjusted)on



### Debt / EBITDA (median, adjusted)



### FFO / Debt (median, adjusted)



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

# Key assumptions

## Telecommunications

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### 1. Demand for data continues to increase

Technological advances and faster internet connections will continue to revolutionize the way we live. Streaming video on ultra-high-definition TV screens, virtual reality applications, real-time online gaming, and smart homes are the wave of the future and have one thing in common: They require high-capacity, low-latency network connections.

We expect cable providers to continue to enjoy an advantage over the local phone company in markets where the telecom is still using copper wire. It is more affordable for cable companies to upgrade electronics in the network to increase speeds and capacity, while the best option for wireline phone companies is to replace the copper wire with fiber, which can be expensive and only economical in more densely populated markets.

### 2. Competition limits profitability improvement

We expect global EBITDA margins to remain relatively flat at around 35% due to intense competition stemming from mature market conditions and the increased commoditization of services. In the U.S., we expect wireless stability as the industry awaits the outcome of the proposed Sprint and T-Mobile merger. Cable providers will continue to experience pay-TV margin erosion from rising programming costs, although that will be offset as they gain customers for their more profitable broadband services. Wireline providers could also experience pressure from an unfavorable shift toward lower-priced SD-WAN and away from legacy products. Meanwhile, fiber providers will likely continue to grow. Issuers will continue to respond with cost cutting and attempts to improve subscriber economics through stickier bundles.

In Europe, the positive trend in telco margins since 2015 will help to grow EBITDA despite flat topline revenue. We expect average margin will improve about 1% to 37% in 2018 on the back of aggressive cost cutting. We think this trend will continue, but expect the pace to begin slowing in 2019 as the easiest cost cuts are achieved. In the GCC, we think the slightly higher telco margins of about 40% on average, will hold stable despite competition and regulatory headwinds, due to cost efficiency initiatives. Meanwhile, European cable margins remain high at about 47%, but we expect only moderate improvements going forward, mainly driven by the economies of revenue growth.

### 3. Increasing capital expenditures on the horizon

According to GSMA, global wireless carriers have invested more than \$1.3 trillion in their wireless networks since 2010, primarily for the deployment of 4G wireless technology, and we expect investment in 5G could prove to be significantly higher than prior generations. This is because carriers need new wireless spectrum, deeper fiber backhauls, particularly in key urban markets, and substantially more cell sites to deliver the benefits of 5G. Against this backdrop, we also believe there are some potential cost benefits because of network element virtualization, improved spectrum efficiency, and the use of fiber optics.

Overall, we expect aggregate capital spending for the global telecom operators to increase, although growth will vary by region. We expect capital spending for the U.S. carriers to increase over the next few years as they build out denser radio networks, acquire spectrum licenses, and invest in fiber infrastructure for 5G. In Canada, we expect wireless capital intensity to increase modestly to support 5G; however, lower spending for 4G and wireline means overall capital intensity will likely remain stable for BCE, fall modestly for Telus and increase for most of the cable providers. We expect aggregate

capital spending for APAC telcos to be relatively flat, including growth in 5G investments, and stable capital intensity, with 5G spending starting to ramp up in 2020 and beyond. Conversely, for Europe, following years of higher capital spending to support 4G network builds and fiber deployments, we expect capital spending to decline this year and remain relatively stable, albeit elevated, through 2021. We believe the majority of 5G-related capital outlays will be after 2020 given that European telcos will likely be fast followers of the U.S. and APAC. Similarly, we expect Canadian operators will lag the U.S. and APAC in 5G deployments.

## North America

In **wireline**, we expect revenues to decline in the mid-single-digit percent area in the U.S. due to the loss of voice access lines to wireless substitution, and broadband customers to cable. Revenue from business services is declining due to competition from cable providers and migration to IP-based technologies, which have lower price points, from legacy frame relay and ATM products. Despite healthy macroeconomic conditions, telecom spending from business customers remains weak. Incumbent wireline companies have also been hurt by wireless carriers turning down legacy copper circuits for wireless backhaul, although we expect some revenue growth from the deployment of fiber to the towers over the next few years. We believe additional consolidation is likely to occur as service providers try to preserve margins and stabilize the top line although there are fewer opportunities. In Canada, by contrast, pricing power in fixed-line broadband combined with modest unit growth should support flat to modestly positive overall wireline revenue growth. Competition is intense, but we expect it to have less of an impact because of a more balanced market structure and network quality disparity.

In **wireless**, we expect service revenue in the U.S. to increase modestly over the next year based on slight subscriber growth and modestly higher ARPU. We believe that T-Mobile will grow service revenue about 5%-7% while AT&T and Verizon will experience 0-2% growth and Sprint will be down modestly. While competitive pressures have moderated over the past year, we still view the U.S. wireless industry as mature and highly competitive with four nationwide carriers. We believe the proposed merger of T-Mobile and Sprint would have a positive impact on the competitive dynamics of the U.S. wireless industry in the near-term if the combination closes. Longer term, we expect that the Internet of Things (IoT) will result in more wireless-enabled products and services, which could create new revenue opportunities for the wireless carriers. While competition in the Canadian wireless market has intensified somewhat from upstarts Freedom Mobile and Videotron, industry subscription growth of 3%-5% in each of the next couple of years should allow for mid-single-digit percentage service revenue growth for the incumbents.

In **cable**, we forecast mid-single-digit percent revenue growth for U.S. cable providers over the next year. Margins will be relatively stable, as the rising cost of programming is offset by growth in higher-margin broadband. For most operators, commercial services continue to increase at double-digit percentage rates as cable raises its share of the SMB market. In the long term, 5G fixed wireless service in the U.S. could take share away from cable broadband or hurt profitability. But given the lengthy time needed to deploy 5G and uncertainty about its profitability and performance, we do not see it as a near-term threat. We also recognize cable's fiber footprint will likely **provide** wireless backhaul opportunities related to 5G that could offset some of the negative effects.

## Europe and Middle East

In Europe, we expect competition will remain intense, reflecting market fragmentation and mature conditions in its highly penetrated markets. Fixed line should outperform mobile operations as a result of lower churn propensity and price competition, and we see converged operators with higher quad-play penetration rates and premium branding as best positioned to weather aggressive challengers.

In markets like **Italy, France, and Spain**, value brand operators are pushing pricing that is already low by global standards even lower in a bid to achieve market scale, forcing many premium operators to respond with a low cost brand of their own. Some European telcos will also face currency headwinds on a Euro-reporting basis from their exposure to emerging market operations. For example, at Telefonica we forecast 1% organic revenue growth in 2018. But we assume currency depreciation on almost 50% of its revenues that are exposed to Latin America, which will drive a 3% decline on a reported basis.

The broad structural impacts of market consolidation from the middle of the decade, and convergence that continues to penetrate the customer base, have helped moderate price competition in many markets, and keep revenue near breakeven. The monetization of mobile data, while substantially lagging the increase in traffic volumes, is nonetheless also helping offset the commoditization of voice and short message service (SMS). At the same time, ARPU trends have improved modestly as a result of tactical price increases in fixed broadband, and increased penetration of multi-play products, supported by improved internet protocol television (IPTV) and high-speed broadband offerings.

Because revenue prospects are flat to slightly negative, we expect cost cutting will be key to higher profitability and EBITDA. With **telcos** shifting capital spending budgets from 4G wireless rollouts to fixed network upgrades, we assume capital spending will average about 19% of revenue over the next two years.

Meanwhile, **cable** growth will rely on adding broadband customers and cross-selling bundled products. But cable growth will moderate as the performance advantage over telecom companies narrows and penetration plateaus within their existing geographic markets. To keep pace with telco fiber and to continue their growth story, we expect cable operators will maintain capital spending at about 22% of revenues over the next two years to fund upgrades to DOCSIS 3.1, as well as footprint expansions to reach new customers.

In the **GCC**, we expect flat top-line growth on adverse regulation in markets like Saudi Arabia. We expect similar fortunes for more diversified players like Etisalat and Ooredoo, but as a result of their exposure to volatile markets in Africa, Asia, and the Middle East outside the GCC, despite more supportive home market regulation and milder competition. In Turkey we expect double-digit revenue growth because of a partial pass through of inflationary pressures to customers, but stable to slightly declining margins, impacted by increased competition and absorption of some FX fluctuation, despite focus on cost efficiencies.

## Latin America

We expect the industry to maintain mid-single-digit percentage growth in 2019, as macroeconomic conditions in the region continue to improve, particularly in Brazil. Next year, industry dynamics will remain driven by the migration of fixed-to-mobile and voice-to-data. Post-paid mobile revenue growth has been leading the way over the last 24 months, and we expect this business line to maintain its healthy growth in 2019, supporting EBITDA margins in the 35% area. For the next 12 months we expect an expansion in the deployment of the 4.5G wireless coverage in Brazil and Mexico, while 4.G technology further penetrates other markets in the region. We consider that the region's leading players will focus on digital transformation, coverage, and capacity to enhance quality and service, which should drive higher data usage and top line growth.

In Mexico, we believe that EBITDA margins will remain somewhat constrained by fierce competition, high subscriber acquisition costs in the wireless segment (on account of post-paid subscriber growth), and increased content charges in the pay-TV segment, which may be exacerbated by the peso's exchange rate volatility relative to the U.S. dollar.

## Asia-Pacific

Excluding Softbank's Sprint deconsolidation effect and foreign currency fluctuations, we expect flattish revenues in 2019 for APAC (on a local currency basis) because steady demand for mobile data is likely to be offset by the ongoing decline in wireline voice revenue and wireless ARPU. We anticipate overall profitability in APAC to be under modest pressure over the next 24 months because of intense competition and regulatory pressure in some regions, including Australia, India and Singapore.

We expect overall capital spending to remain elevated because of the investments needs for advance networks such as 5G (developed markets), 4G (emerging markets) and fiber-based broadband. Nevertheless, good and stable operating cash flows for most incumbent players should support generally stable key credit measures, such as debt to EBITDA.



# Key risks and opportunities

## Telecommunications

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### 1. Next generation of wireless technology, called 5G

5G wireless has the potential to considerably broaden the addressable market for telecom carriers and embed (or cement) them further into varied digital ecosystems and national economies. Near-term use cases or applications of 5G, however, might not prove to be the catalysts for solving lackluster revenue growth in developed markets. Upfront (or long-lead time) investment in capital and wireless spectrum for 5G could prove to be substantially higher than prior generations of wireless deployments due to network density requirements, potentially hurting return of capital metrics. The potential for meaningful revenue to lag 5G buildouts poses significant credit risks for providers pursuing aggressive deployments.

Overall, we have a cautious view on the U.S. and believe that accelerated investments could hurt near-term credit quality when balance sheets are already stretched. In APAC, we expect that moderately higher capital spending will be supported by strong operating cash flows, resulting in stable credit metrics. In Europe, we believe that 5G deployments are likely to be slower relative to other markets, reflecting our view of weaker 5G revenue prospects for the region, but also a more manageable investment period, minimizing leverage concerns over the next two to three years.

### 2. Digital Disruption

Technological advances are changing the way consumers communicate, resulting in increasing data consumption and streaming video. But intense industry competition and the commoditization of services can limit the chance to benefit from these trends. In the wireline industry, traditional landline phone service is being ditched in favor of wireless. In cable, consumers are increasingly cutting the video cord in favor of over the top (OTT) online streaming alternatives, a particular threat in the U.S. given the high contribution of TV into the fixed bundle. Still, cable providers have a natural hedge with their high-margin broadband product. It is important for them, however, to keep churn low, which they often do by bundling services to provide additional value. These providers will benefit from increasing demand for data over the next two to three years, although increasing competition from 5G fixed wireless in the U.S. could, over the long term, limit cable's ability to raise prices. In wireless, more data traffic on the network could necessitate capital investments to increase capacity at the same time that monetizing demand is complicated by intense competition and unlimited data plans. Companies can mitigate the threat of disruptive technologies, such as OTT, and preserve credit quality with prudent investments that maximize competitive position (such as fiber and next generation wireless), sustainable product differentiation, and products and services that earn a strong return.

### 3. A sharp downturn in the global economy in 2019

While telecom services show a weak correlation to macroeconomic factors because they are near necessities, lower discretionary income could result in a modest acceleration in video subscriber losses (to cheaper online alternatives), a decline in business revenue for cable, wireline and infrastructure providers, and modest postpaid wireless subscriber losses (to prepaid).

Clearly, the biggest risk is that tightening credit market conditions could lead to higher borrowing costs and elevated refinancing risk. This is particularly relevant given the substantial increase in global telecom debt, which now approximates \$1.9 trillion, or almost double the amount in 2012. There is also about \$180 billion in global telecom debt

coming due over the next year, much of which will need to be refinanced. We believe the most vulnerable companies are at the lower-end of the rating spectrum. Globally, there are about 45 credits rated 'B' or lower that could face difficulty accessing capital as debt comes due, or that could face reduced cash flow from increased interest expense, making it more difficult to ultimately reduce leverage.

## Industry developments

### 5G carrier strategy

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Despite the excitement and promise of 5G, we have a cautious view on its timing, and our ratings don't yet fully incorporate 5G-specific cost or revenue assumptions. High 5G investment could raise cash flow and balance sheet risk for telecom operators, although there will clearly be new revenue opportunities in the long term.

With modest 4G returns still in mind and 5G use cases likely several years from maturity, we believe telecom operators will take a measured, economically-focused approach that results in a slower global rollout than we saw with 4G. We also believe the deployment will initially be limited to denser urban and suburban markets (except where rural deployments are required by coverage obligations). At the same time, timelines will vary by market and the degree of aggressiveness will depend on several factors, including government policy, financial resources, and technology-driven demand.

**Overall, we expect that carriers in the U.S. and certain Asia-Pacific markets will be aggressive in their 5G buildouts while European and Canadian operators are likely to take a more conservative approach.**

We have a cautious view on the **U.S.** 5G rollout and believe accelerated investments, including the acquisition of spectrum licenses, small-cell network deployments, and elevated costs for 5G equipment could hurt near-term credit quality at a time when balance sheets are already stretched. However, we believe the U.S. tax reform legislation implemented in early 2018 could free up cash flow to help support these investments.

In **Asia-Pacific**, we believe that telecom operators in South Korea, Japan, and China will be able to cover their 5G investments mainly with strong and stable operating cash flows. Therefore, we expect overall credit metrics for the telcos in these markets to remain steady over the next couple of years. But, similar to the U.S., they are likely to be aggressive in their 5G network buildouts.

In contrast, we expect that 5G investments in **Europe** will be slower relative to the US and Asia-Pacific. Capital spending at the European telcos is likely to remain at current levels and not impair credit quality in the near term, provided that spectrum auctions do not significantly weaken balance sheets or cash flow. Being a "second mover" may also carry an additional benefit due to a declining cost curve for equipment. And with the current European focus on fixed upgrades, we think Europe will be well positioned with dense fiber backhaul to be a fast-follower. As a result, we believe that credit implications are limited.

Similarly, we expect that **Canadian** telcos will take a more measured approach to 5G because their credit metrics have weakened due to spectrum and network investments, shareholder returns, and employee pensions.

## Regulatory uncertainty

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### North America

The current Republican administration in the **U.S.** has rolled back Title II regulation by reclassifying ISP's as an "information service" under the lighter-touch Title I classification and removing the "general conduct standard", which reduces the threat of price regulation over the next three years. Furthermore, the tenants of "net neutrality" around no blocking, throttling, or paid prioritization, were removed and replaced with a requirement to provide transparency if a carrier engages in these practices. We do not expect any change in behavior from ISP's until Congress enacts a more permanent solution. Therefore, we view the threat of regulation as a longer-term risk to cable providers and other ISP's because a new administration could employ a more restrictive regulatory regime.

We expect regulation in **Canada** to focus on developing sustainable competition, notably in wireless through spectrum management; establishing a framework for accelerating rural broadband access; developing Canadian content; and protecting consumer interests under a 'net neutral' philosophy. Although regulatory rhetoric is increasing somewhat heading into the 2019 federal elections, we do not see these risks as incrementally material to our sector outlook.

### Europe and Middle East

The US export ban on ZTE in spring, stemming from violations of trade sanctions on Iran, illustrates an increasing risk of **trade disputes** that could affect the telecoms sector. For example, WindTre had partnered with ZTE and was in the midst of its mobile network upgrade when the ban effectively halted work. While it rapidly sought out and secured Ericsson as an alternative supplier, WindTre lost several months against its rollout schedule. The US lifted its ban in summer in the context of easing broader trade tensions with China. But we believe trade risk remains heightened in the current political climate, and think it prudent to mitigate exposure through contingency plans including multisource arrangements. This need will only increase with large 5G investments on the horizon.

**In the UK, the risk of a no-deal Brexit has increased**, but we think such a scenario would affect telecoms less directly than other sectors due to the industry's utility-like demand characteristics. However, there could be incremental indirect risks related to labor availability for network deployments, a rise in sterling prices for foreign currency denominated capital equipment, and other macro-economic related impacts including reduced public and private sector telecom investment that would hit operators' B2B operations.

**Our focus on national telecom regulatory risk in Europe has shifted from mobile pricing to greater regulation of fixed assets.** This can range from regulated wholesale access (which may increasingly expand to include cable networks) to potential separation of incumbent assets in their entirety.

Wholesale access, like we are seeing introduced in Belgium and the Netherlands, could inject more competition into the fixed market, and disproportionately affect incumbents that have traditionally benefited from their monopoly on high margin wholesale operations. However, we think negative impacts could take time to manifest as upfront investments will be needed to create access products.

A separation of fixed networks would represent an even more substantial regulatory step that could significantly weaken our view of European telco business profiles. We have not yet seen a regulator force such a separation in Europe, though this has been the subject of ongoing discussions between Ofcom and BT over Openreach, and by Agicom and TI over

its fixed network. We have also seen the negative credit profile consequences of such a move in Australia with Telstra, and in other sectors such a gas and power distribution assets. A key question in such a scenario is what the telco does with the proceeds, and if deleveraging improves the financial profile enough to offset the weakened business profile.

In the **Middle East**, we note a spate of challenging regulatory measures, notably in Saudi Arabia, including a lifting of the ban on voice over IP services (VoIP), MTR cuts, and biometric registration requirements that reduce the overall market subscriber base. These outweigh the potential more-for-more benefits of a regulatory ban on unlimited mobile broadband packages. Further regulatory risk that could impact profitability may arise from possible changes in royalty structures, or the introduction of new licenses (such as in Oman or Iraq).

### Latin America

Here, we will be paying close attention to politics, including changes in the federal governments of Mexico, Brazil, and Colombia.

In **Mexico**, for instance, President-elect Andres Manuel Lopez Obrador recently said that he plans to cancel the construction of the new Mexico City Airport, following a public consultation launched by the incoming administration. In our view, this will trigger a period of volatility and uncertainty that could undermine investor confidence and consumer sentiment, potentially hindering growth prospects in the near to medium term.

In **Brazil**, the political environment could also weigh on consumer confidence and result in delayed top-line growth. Latin America also remains exposed to potential new regulatory changes that shape industry dynamics and the competitive landscape. One important task for regulators across the region will be to explore new mechanisms that foster competition while also protecting consumers. Although we are not expecting major regulatory changes in 2019, newly installed governments could launch other policy initiatives.

### Asia-Pacific

In APAC, we see gradually increasing regulatory pressures in 2019. The regulator's approval of a new telecom operator will increase competition in Singapore, Japan, and Australia. In addition, some telecom operators in South Korea, Taiwan, and Malaysia have lowered their tariffs as regulators have called for more accessible telecom services.

In **Australia**, the growing presence of the government-driven National Broadband Network (NBN) has pressured some telecom operators' credit quality such as Telstra Corp. Ltd. However, this could also reshape the industry, including the substitution of fixed-line broadband with wireless broadband services utilizing 5G network in the medium to longer term.

## M&A: Low appetite outside the U.S.

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### North America

There have been several transformational acquisitions completed or announced in recent months, including AT&T buying Time Warner, T-Mobile announcing plans to buy Sprint, and Comcast acquiring Sky. If credit markets remain supportive, we believe there could be more deals in 2019 under a benign regulatory environment, and that potential combinations could be driven by the convergence of distribution systems, vertical integration, revenue diversity, technology shifts, and shifting consumer preferences.

### Europe and Middle East

M&A has pressured balance sheets of several major players in the past year, including DT, Vodafone and Telia. We see little regulatory tolerance for further in-market consolidation, but think operators will continue to pursue convergent and cross-border M&A. This could lead to more leveraged balance sheets and rating concerns, as any improvement to business profiles from competitive and scale benefits would need to be substantial to loosen our current rating thresholds. We also see financial policy risk as a result of sluggish equity performance among European telcos that have lagged regional benchmarks. This could lead to increased demands on free cash flow by shareholders. And in some cases, we believe there could also be equity, rather than regulatory pressure for asset spin-offs in hopes of crystalizing their higher valuation potential. Examples of this already include the many tower spins, including Altice in France and Portugal most recently, but we could see consideration expand to fixed assets as has been mooted at TI and TDC.

For the Middle East, we think balance sheet headroom will allow for pursuit of M&A to address competitive pressures. But we see ICT or content services the most likely target rather than cross-border consolidation given limited new license availability outside of Oman and Iraq, and lack of organic growth opportunities given small markets that are already saturated with mobile penetration nearing 200%. In the GCC, a declining capex to sales ratio from 2019 should translate into improving free cash flow generation. In Turkey, we expect a temporary peak in capex to sales in 2018 above 20%, due to the FX impact on hard-currency denominated capex, and then expect a decline from 2019.

### Latin America

Low penetration of telecom services in Latin American countries, compared to mature markets, drives our continued expectation of important capital spending plans, with large companies focusing on enlarging their geographic footprint and supporting high quality services in both mobile and fixed networks. Capital investments should remain between 15% and 20% of revenues. With the expected recovery of the Brazilian economy, we expect more intense competition, although that will not hurt profitability because inflation and labor costs remain low. We also expect telecom operators to continue to pay dividends, as no big potential M&A transactions have been identified.

### Asia-Pacific

In APAC, we expect ongoing M&A activities because major operators are diversifying their revenue streams and positioning themselves for industry change. Korea's SK Telecom acquired security/surveillance service provider ADT Caps, primarily aiming for synergies in its Internet of Things business. We also expect Japan-based SoftBank Group's financial policy to remain aggressive with ongoing M&A for new technologies. In China, we anticipate smaller acquisitions for Internet Data Centers (IDC) given the growing demands for data storage and processing.

## Related Research

- The Future Of 5G: Will Global Telcos Get Enough Bang For Their 5G Buck?, Oct. 17, 2018
- The Future Of 5G: North American Telcos Race To 5G, Putting Balance Sheets At Risk, Oct 17, 2018
- The Future Of 5G: In Europe, Fortune Could Favor The Cautious, Oct. 17, 2018
- The Future Of 5G: In Asia-Pacific, Developed Countries Are Leading The Charge, Oct. 16, 2018
- Credit FAQ: How Long Can Cable Continue To Increase Broadband Revenue? , Jun 6, 2018

This report does not constitute a rating action.

# Cash, debt, and returns

## Global Telecommunications

Chart 9

### Cash flow and primary uses

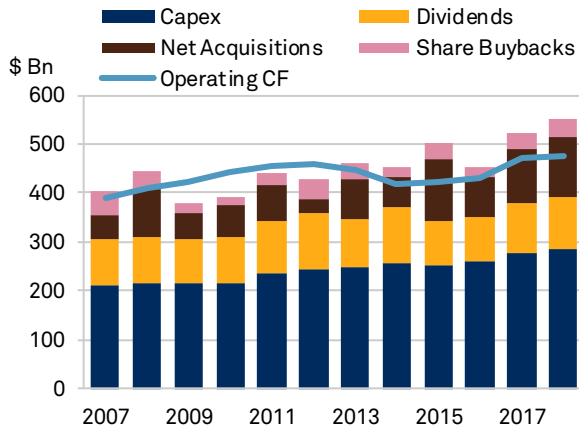


Chart 10

### Return on capital employed

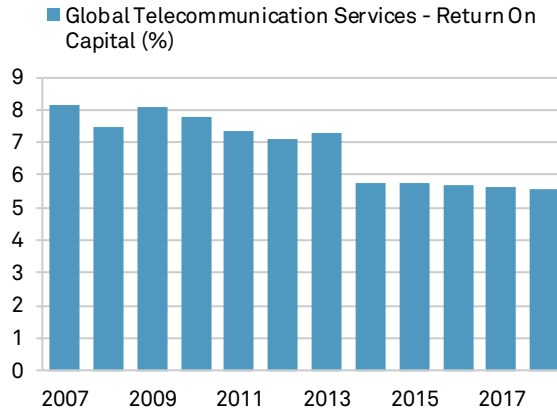


Chart 11

### Fixed versus variable rate exposure

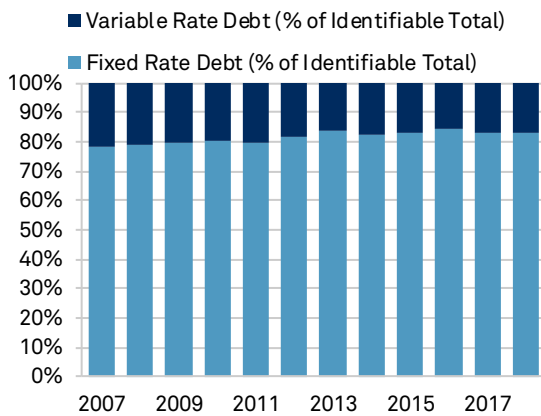


Chart 12

### Long term debt term structure

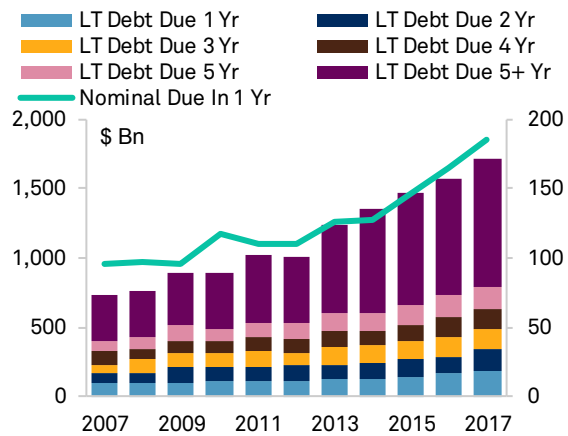


Chart 13

### Cash and equivalents / Total assets

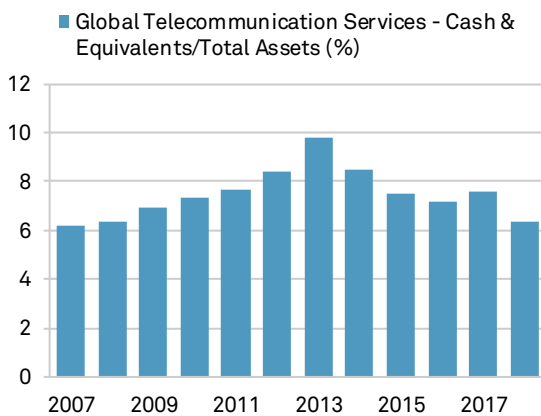
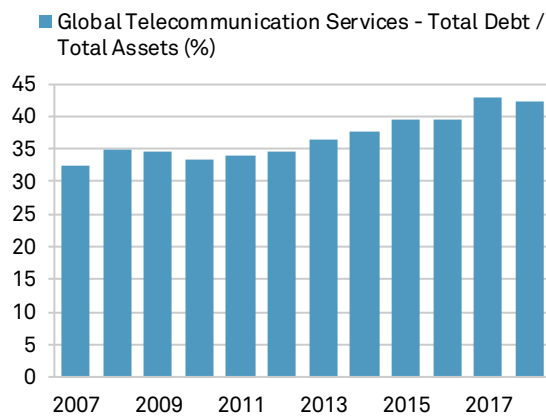


Chart 14

### Total debt / Total assets



Source: S&P Global Market Intelligence, S&P Global Ratings calculations

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