

Fitch Expects to Rate Entel's Senior Unsecured Notes 'BBB+(EXP)'

Written by Australian Business

CHICAGO--([BUSINESS WIRE](#))--Fitch Ratings expects to rate Empresa Nacional de Telecomunicaciones S.A.'s (Entel) proposed USD800 million senior unsecured notes 'BBB+(EXP)'. Fitch has also assigned Long-Term Foreign-Currency and Local-Currency Issuer Default Ratings (IDRs) of 'BBB+' with a Rating Outlook of Stable. The proceeds of the notes will primarily be used for general corporate purposes, including capex in Peru and Chile, as well as to refinance existing debt.

Entel's ratings reflect its leading market position in the Chilean mobile telecommunications industry, historically conservative financial profile, fully integrated service portfolio, strong brand recognition, as well as a moderate regulatory risk in Chile and Peru.

The ratings are tempered by the recent increase in leverage due to the company's USD410 million acquisition of Nextel in Peru and its investment of USD105 million for the 4G spectrum. As of Dec. 31, 2013, Entel's debt-to-EBITDA reached 1.8x from 0.7x a year ago, and Fitch forecasts this ratio to increase above 2x by the end of 2014 given the company's high capex plans in Chile and Peru. However, Fitch expects the ratio to fall towards 2x over the medium- to long-term as the company's market position and cash generation in its Peruvian operation gradually improve.

Key Rating Drivers

Increased Leverage

Entel's financial leverage increased in 2013 as a result of the acquisition of Nextel Peru. Total investment in Peru amounted to about USD515 million in 2013, which was mainly financed with the USD1 billion notes issued in October 2013. As a result, total debt increased to CLP840 billion at end-2013 from CLP436 billion a year ago, which led to the increase in financial leverage to 1.8x from 0.8x during the same period.

The increase in Entel's financial leverage was also partly due to a change in the accounting standard to record the handset cost for postpaid service as an operating

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expense rather than capex as per the previous practice. This has negatively affected the company's EBITDA. Under the same accounting rule, the company's leverage at end-2012 would have been 1.1x.

Negative FCF in Peru

Fitch believes that the acquisition of Nextel Peru will continue to negatively affect Entel's free cash flow (FCF) over the medium term considering the subsidiary's weak operating performance, and projected negative FCF until 2015 due to projected capex of USD300 million in 2014 and USD200 million in 2015. The company plans to fund these investments with part of the proceeds from the proposed notes issuances of USD800 million.

However, Fitch expects the Peruvian operation to start generating positive EBITDA from 2016 and generate enough cash to support their own investment requirement over the long term as its market share improves and the initial network investment phase is completed. As such, Fitch forecasts the company's financial leverage to gradually fall towards 2x over the medium- to long-term.

Positive Diversification

Despite the increase in debt, the ongoing geographical diversification of the company's cash generation is viewed positively. Nextel Peru is the third player in the Peruvian mobile market, with 1.5 million users and a 5% market share at the end of 2013. Sales in 2013 reached USD281 million while EBITDA was negative due to the competitive pressure. After the acquisition, Entel changed Nextel's strategic focus from 'push to talk' service for corporates to the more lucrative voice-and-mobile-data-driven services for corporates and individual subscribers. As the company changes its network's technology and improves the coverage of its network and the retail distribution channel, Fitch expects its market share to gradually improve. The recently acquired 4G spectrum should also support mobile data growth and help improve market share going forward.

The acquisition also complements Entel's existing fixed-line operation in Peru, through its other subsidiary, Americatel Peru. With the addition of Nextel Peru's service, the

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company should be able to provide a convergent service for its corporate clients. Americatel generated USD42 million in revenues with USD8 million of EBITDA in its IT services business, and USD69 million of revenues and USD7 million EBITDA in the call center business in 2013.

Continued Strong Sales Growth:

Entel's revenue grew strongly by 13.9% to CLP1,641 billion in 2013. This was mainly the result of 19% growth in its customer base, reaching 11.9 million (including 1.5 million Nextel Peru), increased penetration of Mobile Broad Band (MBB) in postpaid customers (55% in 4Q'13 vs 42% in 4Q'12), and record sales in corporate businesses. The decline in EBITDA to CLP463 billion in 2013 from CLP531 billion in 2012 was mainly due to the change in the accounting standard. Under the previous standard, the company's EBITDA would have grown by 11% in 2013 from 2012.

Negative FCF; Lower Dividends:

Competitive pressures coupled with a high level of capex and investments in Peru resulted in continued negative FCF in 2013. The company's cash flow from operations was CLP390 billion in 2013, which was not enough to cover the CLP464 billion of capex and CLP89 billion dividend. Fitch does not believe the company will be able to curb the negative FCF generation in the short term given the competitive operating environment as well as its high capex needs.

The company has decided to reduce dividend payments from about 80% to about 50% of net income, a measure approved by shareholders in order to cope with the weak cash generation in the short term. This freed-up cash portion, estimated to be CLP93.7 billion in 2013 and 2014 (USD170 million) will help support capex and mitigate the projected negative FCF to a certain extent.

Rating Sensitivities:

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Fitch will closely monitor the company's financial leverage, especially in light of the challenges Nextel Peru faces in terms of operational turnaround, FCF generation, and high capex needed in the coming years. A negative rating action would be considered in the case of higher-than-expected investments in Peru without any significant improvement in EBITDA that results in a substantial deterioration in the company's financial leverage. Failure to reduce the net leverage towards 2.0x over the medium term could also pressure the ratings.

Fitch does not foresee a positive rating action in light of ongoing investment plans in Peru and Entel's increased leverage compared to historical levels.

Additional information is available at 'www.fitchratings.com'

Applicable Criteria and Related Research:

--'Corporate Rating Methodology', May 2014.

Applicable Criteria and Related Research:

Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=749393

Additional Disclosure

Solicitation Status

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