

## Research Update:

# PLDT Inc. 'BBB+' Rating Affirmed With Stable Outlook On Ability To Withstand Competition

July 12, 2019

## Rating Action Overview

- We expect PLDT Inc.'s business fundamentals to remain unchanged over the next 12-24 months, despite increased competitive pressures.
- In our view, PLDT's leverage will increase and reduce headroom but remain commensurate with the rating. This is despite the company's likely higher capital spending to improve its network.
- On July 12, 2019, S&P Global Ratings affirmed its 'BBB+' long-term issuer credit rating on PLDT. We also affirmed the 'BBB+' rating on the Philippine telecommunication services provider's senior unsecured notes programs.
- The stable outlook over the next 12-24 months reflects our view that PLDT will maintain its dominant market position in the fixed-line segment of the Philippines' telecommunications market. We also expect the company to preserve a substantial portion of its wireless market share, despite the slated entry of a third player in 2020.

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## Rating Action Rationale

We affirmed the ratings because we expect PLDT's business fundamentals to remain largely unchanged despite an improvement in the country risk of the Philippines stemming from strong economic growth prospects. We expect the company's capital spending on network improvement to grow its fixed line segment, particularly home broadband. But this will happen at the cost of higher leverage.

In our view, PLDT will maintain its dominant position and a resilient foothold in the Philippines fixed-line telecommunications segment. The company has increased capital spending to improve its fiber network. The number of homes passed has risen rapidly to 6.3 million in 2018 from 1.2 million in 2016. We believe PLDT's improving fixed-line network puts it in good stead to benefit from growing home broadband demand. The ability of PLDT's fiber offering to support market demand for heavy bandwidth use will bolster uptake.

PLDT should also retain a substantial portion of its wireless market share. Fellow incumbent Globe Telecom overtook PLDT to become the mobile market leader in 2016 in Philippines duopolistic telecommunications industry. While remaining second to Globe in the wireless

segment, PLDT has seen recovery in mobile revenue in recent quarters, in part due to higher mobile data consumption habits in its consumers. Total mobile data usage ballooned to 824 million petabytes (PB) in 2018, from 287 million PB in 2016. Continued growth in mobile internet demand will drive the wireless segment growth.

We expect the third licensed player Dito Telecommunity (formerly Mislattel) to compete on price on its slated market entry in the second quarter of 2020. Some loss of mobile subscribers for PLDT is inevitable, especially in the context of the Philippines' price-sensitive market. About 40% of PLDT's revenue will be exposed to this competition, as the third player will compete in the individual mobile space. PLDT's bundling of its quad-play services will provide continued value to its subscribers. Therefore, we believe that PLDT will preserve a substantial and meaningful proportion of its wireless market share. Overall, we also expect PLDT's growth in fixed-line broadband and enterprise business to offset the effect of competition in its wireless segment, as well as continued decline in traditional voice and SMS services.

PLDT's financial headroom will reduce over the next 12-24 months as its leverage increases to fund capital spending. We forecast the company's ratio of funds from operations (FFO) to debt will rise to 2.3x in 2019 and 2.4x in 2020. Capital spending will remain high during this time as PLDT improves network quality amid heightened competition. The company has articulated a record-high capital spend of Philippine peso (PHP) 78.4 billion in 2019. Nonetheless, we expect leverage to remain within our rating threshold over the next 24 months.

Compared to regional rated peers like Malaysia's Telekom Malaysia Bhd. and Singapore's Singapore Telecommunications Ltd. (Singtel), we view PLDT's business position as weaker. Telekom Malaysia has a monopoly in its fixed-line business, and is also a strategic partner of the government in furthering the country's telecommunications industry. Singtel, on the other hand, has strong geographical diversification and a much larger scale. We also take into account the increased pressure on PLDT's business with Dito's impending entry. Therefore, in our credit assessment of PLDT, we have removed the previous one-notch positive adjustment for comparable rating analysis.

## **Outlook**

The stable outlook reflects our expectations that PLDT will maintain its dominant position in the fixed line segment of Philippines' telecom market, and preserve a substantial portion of its wireless market share over the next 12-24 months. We also expect the company's ratio of debt to EBITDA to be 2.3x-2.4x during this time.

## **Downside scenario**

We could lower the rating if PLDT's capital structure weakens, such that the ratio of debt to EBITDA increases and remains above 2.5x on a sustained basis. This could happen if PLDT's capital spending is higher than we anticipate, or if the company's competitive position or operating performance deteriorates materially due to aggressive competition. The ratio could move above 2.5x in 2019 if revenue remains flat.

## **Upside scenario**

We may raise the rating if PLDT deleverages, such that its ratio of debt to EBITDA declines to sustainably below 2.0x. The company would also have to show sufficient strength to withstand a potential sovereign stress. However, an upgrade is unlikely in the near term due to elevated capital

spending and increased competitive pressures.

## **Company Description**

PLDT was established in 1928 and is the largest integrated telecommunication services provider in the Philippines, with total revenues of PHP165 billion in 2018. We estimate PLDT's overall revenue market share to be about 52%. The wireless and fixed line segments contribute about equally to total service revenues. As of Dec. 31, 2018, PLDT has about 60.5 million mobile subscribers and about 1.8 million fixed line broadband subscribers.

## **Our Base-Case Scenario**

Our base-case scenario assumptions include:

- Philippines' GDP to grow 6.1% in 2019, 6.4% in 2020, and 6.6% in 2021. The telecommunications sector is moderately linked to the GDP growth rate. We believe that local competitive dynamics play a more integral role in the company's performance.
- PLDT's overall revenue to grow 5% in 2019, supported by strong 25%-30% growth in fixed-line broadband revenue, 9% growth in enterprise revenue, and 30%-35% growth in mobile internet revenue. This offsets the continued decline in traditional voice and SMS and in mobile broadband. The wireless segment will decline 4% in 2020 and 8% in 2021. This is because competitive pressures will increase with Dito's slated entry in the second quarter of 2020. Continued fixed-broadband and enterprise-business growth will cushion this impact. Therefore, overall we project revenue growth will slow to 3% in 2020 and be flat in 2021.
- Adjusted EBITDA margin to decline to 43%-45%, mainly due to the implementation of new accounting standards, PFRS 16-Leases. The resultant decline in operating expenses is lower than our adjustments in historical results.
- Capital expenditure of PHP78.4 billion in 2019, and PHP65 billion annually in 2020 and 2021.
- Free operating cash flow to be about a negative PHP13 billion in 2019 before turning to a positive PHP3 billion-PHP4 billion annually in 2020 and 2021, mostly on account of lower capital expenditure.
- Dividend payout of approximately PHP15 billion in 2019, PHP17 billion in 2020, and PHP18 billion in 2021.

Based on these assumptions, we arrive at the following credit measures:

- Debt-to-EBITDA ratio of 2.3x in 2019, 2.4x in 2020, and 2.5x in 2021.
- FFO-to-debt ratio of 37% in 2019, 36% in 2020, and 34% in 2021.

## **Liquidity**

We assess PLDT's liquidity as adequate, with sources of liquidity to exceed its uses by 1.3x in the 12 months to March 31, 2020. We expect net sources to remain positive even if EBITDA declines by 15%.

Our assessment also considers our view that PLDT could significantly scale down spending if fresh funding was scarce or uneconomical. The company's strong standing in the local and international

financial markets supports its funding undertakings. We also believe the company has good banking relationships.

Principal liquidity sources include:

- Cash and cash equivalents of PHP45.3 billion as of March 31, 2019.
- Cash flows from operations that we estimate to be about PHP66 billion in the 12 months to March 31, 2020.
- Proceeds from the sale of equity interest in Beacon Electric Holdings Inc. of PHP2.45 billion over the 12 months ending March 31, 2020.

Principal liquidity uses include:

- Short-term debt maturities of PHP17.3 billion.
- Maintenance capital expenditure that we estimate at PHP55 billion during the same period.
- Dividends of PHP15.6 billion during the same period.

## **Covenants**

We believe PLDT has adequate headroom in the financial covenants on its bank loans over the next 12 months. Major covenants include ratio of debt to equity of no more than 3x and EBITDA interest coverage ratio of at least 1.8x.

## **Issue Ratings - Subordination Risk Analysis**

### **Capital structure**

As of March 31, 2019, PLDT's capital structure consists of PHP174 billion of debt (excluding financial lease obligations). All debt is unsecured, and less than 50% of debt is held at the subsidiaries' level.

### **Analytical conclusions**

We rate PLDT's senior unsecured notes programs 'BBB+', the same as the issuer credit rating. We do not view PLDT's capital structure as having any significant subordination risks. There is no outstanding issue under the programs currently.

### **Ratings Score Snapshot**

Issuer Credit Rating: BBB+/Stable/--

Business risk: Strong

- Country risk: Moderately high
- Industry risk: Intermediate
- Competitive position: Strong

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Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bbb+

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital Structure: Neutral (no impact)
- Financial Policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb+

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Telecommunications And Cable Industry, June 22, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

### Ratings Affirmed

#### PLDT Inc.

Issuer Credit Rating	BBB+/Stable/--
Senior Unsecured Programs	BBB+

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