Fitch Affirms PLDT at 'BBB'; Outlook Stable

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Fitch Ratings - Hong Kong - 26 May 2020: Fitch Ratings has affirmed PLDT Inc.'s Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) at 'BBB'. The Outlook is Stable.

PLDT's ratings reflect its robust market position in both the fixed and wireless markets in the Philippines. However, the rating headroom is very limited, as we expect FFO net leverage in 2020 and 2021 to be around 2.8x - the level at which Fitch would consider negative rating action. Slower growth amid the coronavirus pandemic, elevated capex and dividend commitments are likely to widen negative free cash flows (FCF). The pace of deleveraging could pick up if PLDT decides to dispose of more assets to reduce debt, or if EBITDA expansion were to be stronger than we expect.

KEY RATING DRIVERS

Impact from Coronavirus The coronavirus pandemic is likely to slow PLDT's near-term revenue growth, as mobile traffic shifts to home broadband amid restrictions to contain the spread of COVID-19. We forecast 2020 revenue to grow by a low- to-mid-single digit percentage (2019: 3%) as slower economic activity curbs consumer and enterprise spending.

We expect PLDT's wider service diversification and a more entrenched fixed-line position to help mitigate revenue pressure in its wireless business, compared to rival Globe Telecom (BBB-/Stable). However, we could further revise down our revenue forecast if measures to contain the spread of COVID-19, such as the Enhanced Community Quarantine, are prolonged.

Delay in Cash Conversion Cycle: Fitch forecasts a longer cash collection cycle due to PLDT extending the payment period by 30 days for postpaid customers and providing a six-month installment programme. These are temporary relief measures, but we expect PLDT to continue to take a more lenient approach on payment collection through end-2020 in light of the recession, and to start to tighten consumer credit in 2021. Fitch forecasts the Philippines' economy to contract by 1% in 2020, before growing by 7% in 2021.

Elevated Capex, Negative FCF: We forecast PLDT's FCF to continue to be negative in 2020-2021, as cash flow from operations will be insufficient to fund high capex and the dividend commitments of 60% of the previous year's core income. We forecast 2020 capex to be around PHP63 billion (2019: PHP88 billion) to continue to expand mobile coverage and capacity, and to roll out of its fixed-broadband network.

PLDT originally guided for PHP83 billion of capex for 2020, but later indicated that 20%-25% will be deferred to 2021 as the network rollout has been hampered by labour shortages. PLDT will prioritise spending to maintain service quality and customer experience, such as network maintenance and repair. New projects such as the 5G rollout are likely to be postponed, while business capex, which was originally budgeted at PHP18.5 billion, may also be reduced. We expect PLDT's capex to be PHP65 billion-78 billion in 2021-2022 to support growing data traffic and resume 5G development.

Aggressive Fibre Rollout: PLDT's fibre expansion underscores its strategy to capture growth in the home-broadband and enterprise segments and strengthen its network ahead of the entry of a third telco in 2021. PLDT's fibre coverage passed 7.5 million homes by end-March 2020 (1Q19: 6.7 million), with 3.6 million in fibre-port capacity of which 1.1 million fibre ports were available for sale.

We expect PLDT to continue to expand its fibre footprint once quarantine restrictions are eased to strengthen its position ahead of the entry of the new competitor. PLDT allocated PHP18.5 billion as business capex in the original capex budget - mainly for last-mile connections and customer premises equipment - though this amount could vary depending on the pace of connections and upgrades for fibre-broadband services.
Stronger Network Performance: We expect that PLDT's strong network performance to continue to support its solid market position in both the fixed and wireless markets.

PLDT outperformed Globe in mobile network performance in terms of user experience, download/upload speed and network latency, according to Opensignal. PLDT also had the fastest fixed-line network in the Philippines in 2019, according to research by Ookla. We believe that it is a result of higher network investment by PLDT in 2018-2019, with its total cash capex 44% higher than Globe over that period.

Mobile Data as Growth Driver: PLDT's 1Q20 mobile data revenue grew 39% yoy, driven by an increase in customers' data usage as it promoted LTE upgrades and engaged customers, such as marketing specific data packages for gaming or social networking purposes. Its 1Q20 mobile traffic doubled to 636 petabytes yoy, driven by increased usage of data for video streaming and e-games. The company increased its LTE/4G base stations to 26,000 (2018: 16,000) to expand 3G and 4G population coverage to 94% by end-March 2020.

Delay in Entry of Competitor: Fitch expects competition in the Philippine telecom market to remain stable over the next 12 months, with the commercial launch of a third telco, Dito Telecommunity, likely to take place no earlier than 1H21 given the pandemic. Dito received its telco licence in July 2019 after a six-month delay in obtaining approval from the regulator.

It will take time for the new entrant to build comprehensive mobile coverage and a customer base, but the coronavirus containment measures are likely to delay the rollout of network infrastructure due to labour shortage and supply chain issues. There is no mandatory ruling for infrastructure-sharing in the Philippines, although a tower-sharing framework may be introduced for new tower builds.

Partial Funding via Asset Sales: PLDT will receive the remaining PHP2.8 billion from Metro Pacific Investments Corp. in 2020 for the sale of its shares in Beacon Electric Asset Holdings Inc., which should help keep FFO net leverage at around 2.8x. In addition, PLDT is considering the sale of properties and its remaining stake in Germany's Rocket Internet to help fund its capex, though we did not consider these in our analysis. PLDT intends to maintain a long-term net debt/EBITDA ratio of 2.0x.

Robust Market Position: PLDT's ratings are supported by its established position as the largest integrated telco in the Philippines and it competitive strength in both fixed and wireless services. It had a revenue market share of 66% in the fixed-line market and 44% in mobile in 2019. PLDT's EBITDA contribution from the fixed segment was around 39% in 2019 (2018:47%), while the remaining 61% was from the wireless segment (2018: 53%).

DERIVATION SUMMARY

PLDT is rated higher than its closest peer, Globe Telecom, Inc. (BBB-/Stable), due to its robust position in both fixed and wireless markets.

Globe gained revenue share in the mobile segment over the last few years at the expense of PLDT. Globe's mobile revenue share was 53% in 1Q20 (2019: 56%), but still trails PLDT at 47% of total telecom revenue share. PLDT's fibre-broadband strategy offers long-term growth and bundling opportunities, against the new mobile entrant.

PLDT is also rated a notch higher than India's Bharti Airtel Limited (BBB-/Stable), despite the latter's better revenue diversity. This is because the intense competition in India justifies a tighter leverage threshold of 2.5x, in terms of FFO adjusted net leverage, for Bharti at a 'BBB-' rating.

Fixed-broadband operator Telekom Malaysia Berhad (TM, A-/Negative, Standalone Credit Profile: bbb+) has a leverage profile similar to PLDT, but is in a better position due to its market dominance and more modest competition in Malaysia's fixed-broadband market. However, TM's strengths are offset by its thinner operating EBITDA margins, which are likely to narrow further due to pressure on broadband tariffs. TM's IDR incorporates a one-notch uplift from its Standalone Credit Profile due to its links to the Malaysian state.

Thailand's third-largest mobile operator, Total Access Communication Public Company Limited (DTAC, BBB/Negative, standalone: bbb-) is rated a notch lower than PLDT on a standalone basis to reflect its weaker market position, lack of product diversification and a highly competitive Thai mobile market, which offset its slightly more conservative balance sheet, with leverage of around 2.0x. DTAC's 'BBB' IDR incorporates a one-notch uplift to reflect moderate linkages with its parent, Telenor ASA of Norway.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Revenue to grow by low- to mid-single digits in 2020 as the strong growth is interrupted by the impact from the coronavirus pandemic on mobile revenues. After that, we assume revenue to grow by mid-single digits, in line with the economic growth of the Philippines
- Pre-IFRS 16 lease-adjusted EBITDA margin to stabilise at 42%-43% (2019: 44%)
- Credit payment extensions to increase cash-collection cycles and working capital outflows in 2020
- Annual cash capex of PHP63 billion in 2020 (2019: PHP88 billion) as its infrastructure rollout is constrained by the pandemic. We assume capex to be PHP65 billion-78 billion in 2021-2022
- PHP2.8 billion proceeds in 2020 for the sale of Beacon shares
- No further capital injection in Voyager except for PHP1 billion in 2020
- Dividend payout of 60% based on previous year's core income, as per the company's stated policy (2019: 60%)
- No M&A transactions or major divestments

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:
- Positive rating action may arise from easing in the competitive environment or lower capex leading to FFO net leverage declining to below 2.3x on a sustained basis
Factors that could, individually or collectively, lead to negative rating action/downgrade:
- Debt-funded acquisitions or a sharp deterioration in the company's operating profile leading to FFO net leverage rising above 2.8x for a sustained period

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity: PLDT's unrestricted cash balance of PHP34 billion as of end-March 2020 and committed undrawn credit facility of PHP17 billion are sufficient to fully cover its short-term maturities of PHP39 billion. The company's liquidity is also supported by its strong access to capital markets and bank loans. Potential divestment of its remaining shares in Rocket Internet and sale of real-estate assets could add to financial flexibility, should these materialise. Fixed-rate loans comprised 89% (2019: 88%) of the total at end-March 2020, after taking into account its long-term interest rate swap contracts.

Well-Laddered Debt Maturity: PLDT's total on-balance-sheet debt of PHP206 billion as of end-March 2020 is well spread out, with over 70% of debt due after 2022. Around 7% of debt was in US dollars (1Q19: 12%), and they were unhedged (1Q19: 7% unhedged). Dollar-linked revenue - from international long-distance calls, international leased lines and mobile virtual operator businesses - provide a natural hedge at 17% of PLDT's consolidated service revenue (1Q19: 15%).

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
PLDT Inc.	LT IDR	BBB	Affirmed	BBB
	LC LT IDR	BBB	Affirmed	BBB