

Industry Top Trends Update

Telecommunications

Stable outlook despite inflation and reduced market access

What's changed?

Inflation is affecting cost structures. While less damaging than in other sectors, higher energy, labor, and material costs pose risks to margins and capital expenditure (capex) budgets. We expect efficiency programs, along with power purchase agreements and energy hedges, will contain the margin impact to low-single-digits before pricing responses. Delayed investments can push capex out, keeping a lid on annual investment budgets at 18% of revenue on average.

Transaction levels have dropped. Telecom refinancing needs are modest after years of extending maturity walls in a near-zero interest rate environment, but about a third of speculative-grade telecom debt is floating rate, and of over €21 billion in 2022-2023 maturities, a quarter is outstanding. These issuers are now facing higher borrowing costs to refinance (currently 7%-8% annual yields).

What to look out for?

The ability to pass through higher costs via price hikes might be uneven. We have seen significant price hikes by operators in Northern Europe markets. While positive for top lines and margin preservation (in some cases even outstripping cost inflation), higher churn could follow if any operators break from the herd. A split could emerge versus Southern Europe markets, which lack contractual escalators and where fierce competition makes price hikes more difficult.

Potential deals to watch include in-market consolidation in Spain, the sale of DT's towers, and the creation of a monopoly fixed-line infrastructure player in Italy. Outcomes could help clarify the extent governments have rebalanced their priority between incentivizing investment versus customer protection. However, major price hikes could temper the recalibration hinted at last year when wholesale regulation was loosened in several markets, including the U.K. and Spain.

What if there's a recession?

Telecoms are a relatively safe harbor. We expect modest, low-single-digit top-line growth, and the utility-like nature of telecoms should cushion against economic volatility. Even under a recession downside scenario, we expect adjusted debt to EBITDA will only rise by 1.2x for speculative-grade issuers, the second-lowest among 19 corporate sectors.

Asset sales could slow. Rising interest rates could erode the high valuation multiples, and the number of suitors for telecom infrastructure spins, curbing a monetization opportunity that operators have used to increase financial flexibility.

Inflationary price hikes should be handled with care. Operators can point to higher costs and the unmonetized economic value they provided through the pandemic to justify higher pricing. However, aggressive price hikes that push all the pain to customers might be viewed as overreach. If seen to be taking advantage of inflation, operators may inadvertently open the door to competition or regulatory pushback.

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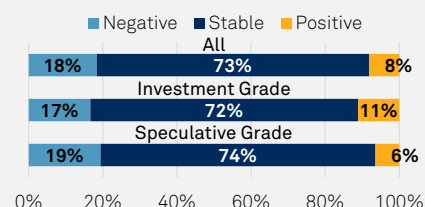
- [How Cyber Risk Affects Credit Analysis For Global Corporate Issuers](#), March 30, 2022
- [EMEA Telecoms: Relative Strength Ranking 2022](#), March 29, 2022
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