

Telecom
Peru
Credit Analysis

Telefonica del Peru S.A.A. – TDP

Ratings

Security Class	Current Rating
Local Currency IDR	BBB+
Foreign Currency IDR	BBB-
Sr. Notes Due 2016	BBB-

Outlook

Stable

Financial Data

Telefonica del Peru S.A.A.

LTM	09/30/07	12/31/06
Revenues (US\$ Mil.)	1,410.3	1,372.7
FFO (US\$ Mil.)	357.7	300.5
Adj. EBITDA (US\$ Mil.)	610.5	622.4
Debt (US\$ Mil.)	887.2	809.3
FFO Adjusted Leverage (x)	2.2	2.3
FFO Interest Coverage (x)	7.4	6.7
LIS (000)	2,558	2,504
Broadband Acc. (000)	555	468

Analysts

Sergio Rodriguez, CFA
+52 81 8335 7179
sergio.rodriguez@fitchratings.com

Daniel R. Kastholm, CFA
+1 312 368-2070
daniel.kastholm@fitchratings.com

Related Research

- [Latin America TMT 2008 Outlook, Jan. 28 2008](#)
- [Newsletter, Global TMT Quarterly, Jan. 17 2008](#)
- [Press Release, Jan. 18, 2008.](#)
- [Newsletter, Global TMT Quarterly, Oct. 18, 2007.](#)
- [Press Release, Jan. 18, 2008](#)
- [Press Release, Sept. 21, 2006.](#)
- [Credit Update, Sept. 11, 2006.](#)

Rating Rationale

- Telefonica del Peru S.A.A.'s (TDP) ratings are supported by its solid business position as the largest Peruvian telecommunications company, diversified revenue stream from its various business segments, healthy cash flow generation, relatively low capital-expenditure needs and strong financial profile. The ratings incorporate regulatory risks, continued pressure on local-service traffic, heightened competition and the acquisition of approximately 17% of Telefonica Moviles del Peru Holding S.A.A. by TDP during December 2007.
- TDP's leading position in local service, with an estimated 98% market share, provides the company with a stable source of cash flow due to economies of scale, extensive network coverage and an established brand name. Local service accounted for 35% of revenues for the nine months ended Sept. 30, 2007. TDP's strategy of growing its broadband and cable television businesses should continue to help diversify its revenues away from local regulated services.
- The company's financial profile is strong and expected to remain consistent with the rating category. For the latest 12 months (LTM) ended Sept. 30, 2007, leverage measures of funds from operations (FFO) adjusted leverage and total debt to EBITDA were 2.2 times (x) and 1.5x, respectively, and coverage ratios of FFO interest coverage and EBITDA to interest expense were 7.4x and 10.5x, respectively. Healthy free cash flow generation provides the company with financial flexibility.
- The ratings incorporate regulatory risk and heightened competition in the Peruvian telecom market, which have driven rates downward, particularly in the local and long-distance segments. Fitch Ratings believes regulatory risk should moderate over the next few years after the government-negotiated tariff reductions with TDP and the setting of the new productivity factor for the 2007–2010 period.

Key Rating Drivers

- Leading market positions.
- Strong free cash flow generation.
- Ownership by Telefonica S.A.
- Regulatory risk.
- Increased competition.

Recent Events

Fitch expects the new productivity factor will have a slight negative effect to TDP's financial performance over the medium term. On July 27, 2007, Osiptel announced the new productivity factor of 6.42% annual reductions to local-service rates to be applied for the 2007–2010 period starting Sept. 1, 2007. The new productivity factor will have an economic effect on local-service rates once it has reached the level of the tariff reduction set by the agreement between the Telefonica group and the government, which is expected to take place by the end of 2008. During the first quarter of 2007, TDP reduced the monthly service charge between 12% and 29% to 1.5 million lines in service (LIS) as part of the agreement reached by the two parties after pressure from the

TDP Revenue Mix – Thousand USD as of Sept.30,2007

(US\$ 000, Years Ended Dec. 31)

	Period Average Foreign Exchange				
	3.1843	3.2772	3.2957	3.4112	3.4784
	LTM				
	9/30/07	2006	2005	2004	2003
Local Service	501,161	505,021	386,771	435,390	440,454
Public and Rural Service	213,045	229,215	181,452	198,575	201,886
Internet	203,107	167,629	119,279	0	0
Long Distance	137,411	157,032	129,751	93,342	103,557
Data and Business Communications	93,409	93,957	24,769	91,375	76,797
Pay Television	131,044	108,591	103,261	99,256	91,997
Others	131,069	111,254	122,887	96,161	76,320
Total	1,410,246	1,372,700	1,068,170	1,014,099	991,011

2007 numbers include some reclassifications primarily between Public and Rural Service and Long Distance.

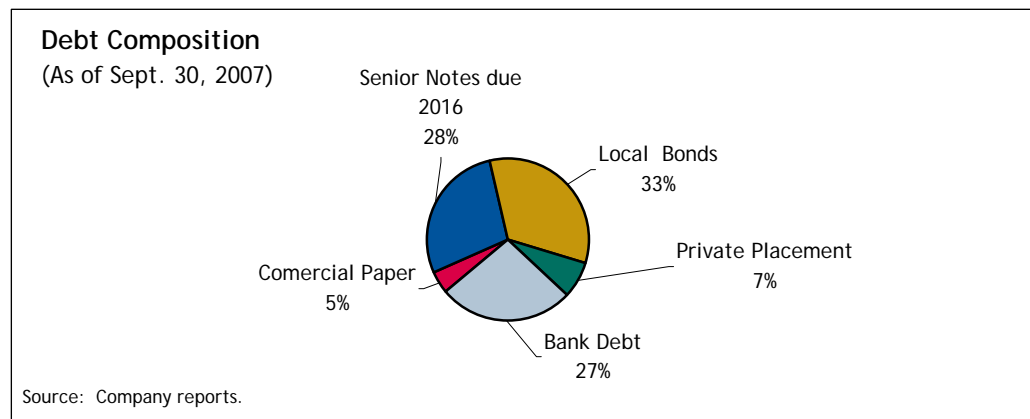
government to further reduce rates. In addition, Telefonica agreed to invest approximately US\$1 billion over the 2006–2009 period, of which US\$250 million will be invested by TDP for its broadband business. Fitch believes these investments can be financed with internally generated cash flow.

In December 2007, TDP acquired a 17.4% stake in Telefonica Moviles Peru Holding S.A.A., which owns 96.1% of Telefonica Moviles S.A.A., the leading mobile provider in Peru with an estimated 60.5% market share. For the nine months ended Sept. 30, 2007, Telefonica Moviles S.A.A. had revenues and EBITDA of approximately US\$594 million and US\$152 million, respectively. On Dec. 30, 2006, TDP merged with holding company Telefonica Peru Holding S.A.A. This transaction did not imply any change in control or cash. TDP is now directly own by Telefonica Internacional, a subsidiary of Telefonica.

Liquidity and Debt Structure

Fitch expects TDP’s EBITDA margin to remain relatively stable over the next few years. For the 12 months ended Sept. 30, 2007, the company’s EBITDA margin declined to 41.7% from 45.3% in 2006. The decline in margins reflects the government agreement to reduce rates and a change in reporting other expenses, which are mostly related to noncash charges. These charges did not affect FFO and cash flow. Adjusting for these charges, TDP’s EBITDA margin was 43.2% for the LTM ended Sept. 30, 2007.

Fitch expects that TDP should continue to have a financial profile consistent with the rating category. Leverage has remained somewhat stable over the past few years as FFO adjusted leverage has been approximately 2.2x and total debt to LTM EBITDA has ranged between 1.3x–1.5x over the past three years. Fitch expects capital expenditures for the



Profile

TDP is the leading Peruvian telecommunications provider and participates in several segments, including fixed local services (35% of nine-month revenues as of Sept. 30, 2007), public and rural phone services (15%), long distance (9%), Internet (14%), cable television (10%), business communications (6%) and other services (11%). As of Sept. 30, 2007, the company had approximately 2.6 million LIS, 555,000 broadband lines and 628,000 pay-tv subscribers. TDP is 98% owned by Spain's Telefónica.

next few years, including those derived from the government's agreement with the Telefonica group, will be financed with internally generated cash flow.

TDP's maturity profile is manageable, as the company's strong cash balances, healthy free cash flow generation and access to capital markets tempers any potential liquidity issue. The liquidity ratio of free cash flow plus cash dividends by current maturities was 1.4x for the 12 months ended Sept. 30, 2007, and has traditionally remained more than 1.0x, ensuring good liquidity prospects.

As of Sept. 30, 2007, the company's total debt was approximately PEN2.8 billion, or US\$903 million, with 73% market debt and 27% bank debt. Despite having 27% of its debt originally issued in US dollars, the company's strategy is to have most of its debt hedged to the Peruvian nuevo sol, as the company generates most of its revenues in local currency and only a small portion, related to international long-distance settlements, is generated in US dollars.

Financial Summary – Telefonica del Peru, S.A.A.

(US\$ 000, Years Ended Dec 31)

	LTM 9/30/07	2006	2005	2004	2003
Profitability (%)					
Operating EBITDA	587,807	622,440	582,599	515,715	438,940
Operating EBITDAR	587,807	622,440	582,599	515,715	438,940
Operating EBITDA Margin	41.7	45.3	54.5	50.9	44.3
Operating EBITDAR Margin	41.7	45.3	54.5	50.9	44.3
FFO Return on Adjusted Capital	21.7	20.5	29.5	30.4	27.7
FCF Margin	11.6	11.3	16.2	23.2	16.9
Return on Average Equity	4.5	6.8	10.5	1.7	0.3
Coverage (x)					
FFO Interest Coverage	7.4	6.7	7.2	11.2	10.3
Operating EBITDA/Interest Expense	10.5	11.8	9.5	14.3	11.0
Operating EBITDAR/Interest Expense + Rents	10.5	11.8	9.5	14.3	11.0
Operating EBITDA/Debt-Service Coverage	2.0	2.0	2.0	1.9	2.3
Operating EBITDAR/Debt-Service Coverage	2.0	2.0	2.0	1.9	2.3
FFO Fixed-Charge Coverage	7.4	6.7	7.2	11.2	10.3
FCF Debt-Service Coverage	0.8	0.7	0.8	1.0	1.1
(FCF + Cash and Marketable Securities)/Debt-Service Coverage	1.4	0.8	1.4	1.0	1.2
Cash Flow from Operations/Capital Expenditures	1.8	1.9	2.0	2.6	2.7
Capital Structure and Leverage (x)					
FFO Adjusted Leverage	2.2	2.3	1.8	1.4	1.3
Total Debt with Equity Credit/Operating EBITDA	1.5	1.3	1.4	1.1	1.2
Total Net Debt with Equity Credit/Operating EBITDA	1.2	1.2	1.0	1.0	1.2
Total Adjusted Debt/Operating EBITDAR	1.5	1.3	1.4	1.1	1.2
Total Adjusted Net Debt/Operating EBITDAR	1.2	1.2	1.0	1.0	1.2
Implied Cost of Funds (%)	3.2	6.6	9.1	6.6	2.6
Short-Term Debt/Total Debt	0.3	0.3	0.3	0.4	0.3
Balance Sheet					
Total Assets	2,715,124	2,567,607	2,103,680	2,159,615	2,192,717
Cash and Marketable Securities	187,944	41,027	185,408	19,314	14,445
Short-Term Debt	232,494	253,452	235,979	241,096	152,591
Long-Term Debt	670,363	555,879	559,728	311,113	383,263
Total Debt	902,857	809,331	795,707	552,209	535,854
Total Debt with Equity Credit	902,857	809,331	795,707	552,209	535,854
Off-Balance-Sheet Debt	—	—	—	—	—
Total Adjusted Debt with Equity Credit	902,857	809,331	795,707	552,209	535,854
Total Equity	1,062,896	958,053	644,071	831,774	953,712
Total Adjusted Capital	1,965,753	1,767,384	1,439,778	1,383,983	1,489,566
Cash Flow					
FFO	357,707	300,526	379,161	368,198	371,385
Change in Operating Working Capital	14,343	27,987	(28,876)	12,195	(33,974)
Cash Flow from Operations	372,050	328,513	350,285	380,393	337,411
Total Nonoperating/Nonrecurring Cash Flow	—	—	—	—	—
Capital Expenditures	(208,890)	(173,529)	(175,700)	(144,774)	(123,391)
Dividends	60	—	(1,145)	(110)	(46,481)
FCF	163,219	154,983	173,440	235,509	167,538
Net Acquisitions and Divestitures	3,119	3,054	(32,669)	8,075	21,975
Other Investments, Net	(128,156)	(116,909)	715	—	—
Net Debt Proceeds	44,050	(16,016)	265,464	(13,326)	(191,044)
Net Equity Proceeds	—	—	—	(6,419)	—
Other Financing, Net	(316)	(179,187)	(233,738)	(217,845)	—
Total Change in Cash	81,916	(154,076)	173,213	5,994	(1,531)
Income Statement					
Net Revenues	1,410,246	1,372,700	1,068,170	1,014,099	991,011
Revenue Growth (%)	NA	29	5	2	(71)
Operating EBIT	167,329	212,667	231,953	248,851	187,711
Gross Interest Expense	55,811	52,820	61,625	36,075	39,895
Rental Expense	—	—	—	—	—
Net Income	36,599	54,317	77,849	14,923	6,310
Maturity Schedule					
	2007	2008	2009	2010	2012+
	172,320	78,793	143,211	68,434	387,525

Continued on next page.

Financial Summary – Telefonica del Peru, S.A.A. (continued)

(Years Ended Dec 31)

	LTM 9/30/07	2006	2005	2004	2003
Other Key Measures					
Lines in Service (000)	2,558	2,504	2,348	2,151	1,964
Lines in Service per Employee	625	635	681	682	592
Broadband Lines (000)	555	468	340	205	91
Pay-Television Subscribers	628	557	462	389	363
Local Traffic (Mil. Minutes)	4,712	4,883	4,949	5,333	6,061
Long-Distance Traffic (Mil. Minutes)	1,419	1,316	1,178	969	913

Source: Company Reports

Copyright © 2008 by Fitch, Inc., Fitch Ratings Ltd. and its subsidiaries. One State Street Plaza, NY, NY 10004.

Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. All of the information contained herein is based on information obtained from issuers, other obligors, underwriters, and other sources which Fitch believes to be reliable. Fitch does not audit or verify the truth or accuracy of any such information. As a result, the information in this report is provided "as is" without any representation or warranty of any kind. A Fitch rating is an opinion as to the creditworthiness of a security. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed, suspended, or withdrawn at anytime for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from USD1,000 to USD750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from USD10,000 to USD1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of Great Britain, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.