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LatAm Telecoms Primer

Next generation networks

Mobile competition is easing in most
LatAm countries, compared with
2015-2020...

...while fixed broadband remains
highly competitive across the region,
with extensive fiber deployment

Impact of corporate actions key
to share price movement; future
of Telefonica ex-Brazil key for
competitive evolution

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LatAm Telcos snapshot

We see five key themes for LatAm telecoms



Mobile competition easing

Most improved: Brazil;
Most competitive:
Colombia



Fixed broadband remains highly competitive

Highest growth potential: Peru; Most competitive: Brazil



M&A and infrastructure monetization impact in focus

Major events: Brazil mobile M&A and AMX tower spin-off



Telefonica HispAm future

Crucial for the evolution of competition



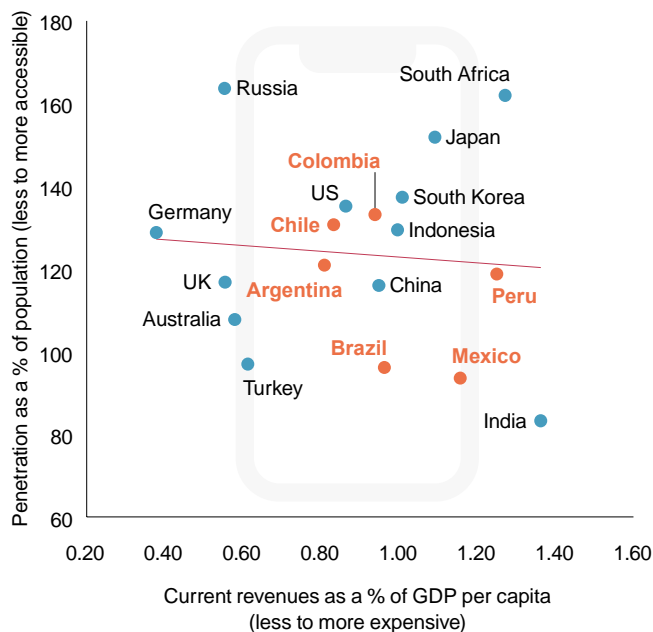
Macro evolution

A key investor concern impacting equity markets

Compared to global peers, mobile and fixed broadband penetration remain low in LatAm

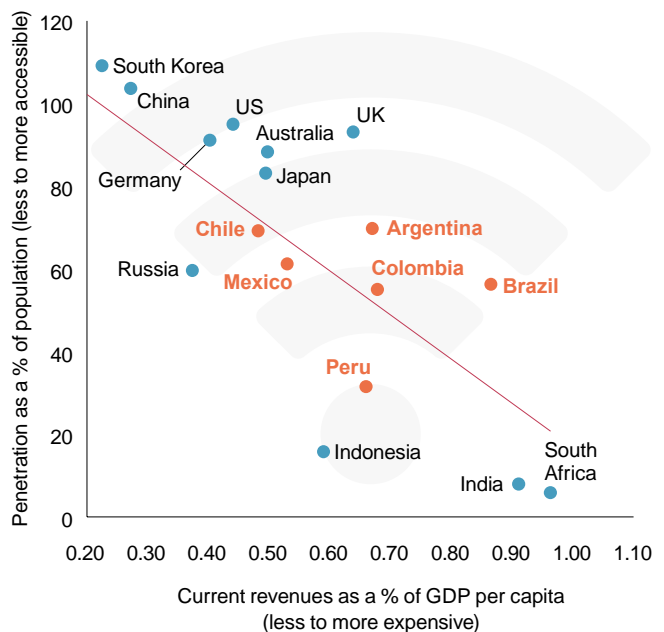
Mobile: Brazil and Mexico remain well below the trend line, with both markets showing high potential.

LatAm mobile penetration vs affordability for major countries (2020)



Fixed broadband: Peru has the highest potential for growth in a competitive landscape.

LatAm fixed broadband penetration vs affordability for major countries (2020)



Source: Company data, World Bank, HSBC estimates

Next generation networks

Key themes in LatAm telecoms

We see five key themes for LatAm telecoms: i) Mobile competition is easing across LatAm; ii) the fixed broadband segment remains highly competitive; iii) the impacts of M&A and divestitures are key to telecom share prices; iv) the future of Telefónica HispAm is key for competition; and v) the macro environment needs to be closely watched.

1. Mobile competition generally easing in major LatAm countries

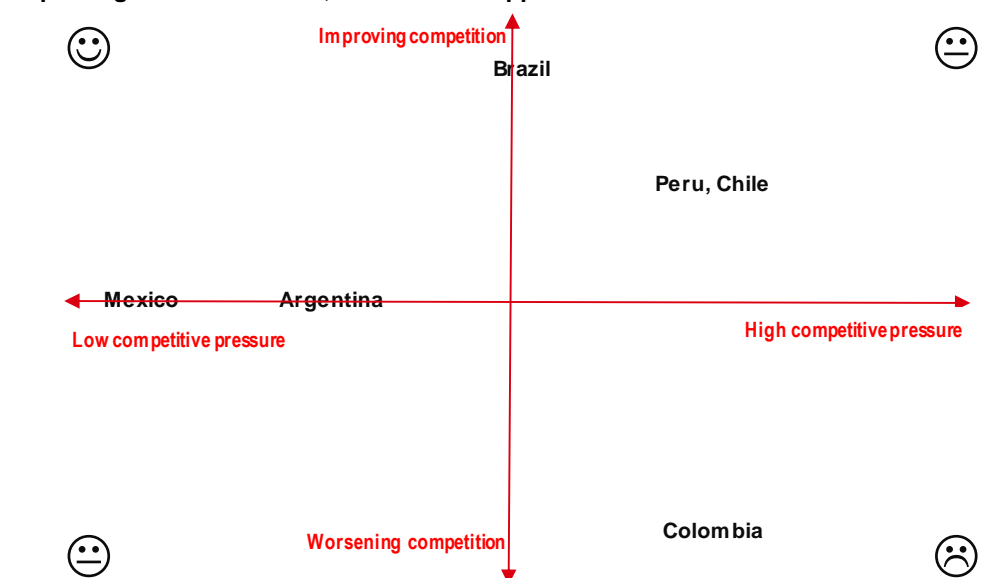
Across LatAm, we see the mobile competition in major countries easing. Mobile consolidation in **Brazil** should help ease the competitive environment in that country, with the number of national operators declining to three (from four).

In **Mexico**, América Móvil has largely been able to defend its mobile market share in the past 2-3 years. With Telefónica set to complete its return of spectrum to the state in 2022, the market will reduce to two MNOs (América Móvil, AT&T), one quasi-MVNO (Telefónica Mexico), and a wholesale operator (Red Compartida). We don't foresee an increase in the competitive environment in Mexico in the near future.

In **Argentina**, the focus for mobile companies remains on tackling inflation and passing the pricing pressure on to consumers. In **Chile** and **Peru**, the new operators that caused intense competition between 2015-20 have gained scale and we anticipate moderate competition compared to 2015-20. The only exception remains **Colombia**, where we expect a new entrant, WOM, to increase competition in the next couple of years.

Mobile competition: we expect Brazil to be the most improved and Colombia the most competitive

Exhibit 1 - Mobile market structure: Among LatAm markets, Brazil looks to have the most improving market structure, while Mexico appears the most rational



Source: HSBC estimates

5G use cases and capex impact likely to be keenly watched by investors

5G auctions and capex implications likely to be a key topic in the next couple of years

Chile and Brazil are two of the larger LatAm nations to have conducted 5G auctions so far. In Brazil, the majority of auction obligations are in the form of coverage commitments by operators. We think that the obligations-heavy structure is a preferable auction structure: leaving operators with resources to deploy network rather than paying higher spectrum costs upfront. Peru, Colombia, and Mexico are expected to hold 5G auctions within the next two years. The impact of upcoming 5G auctions and rollout of 5G networks on capex intensity will likely be keenly watched by LatAm telecom investors.

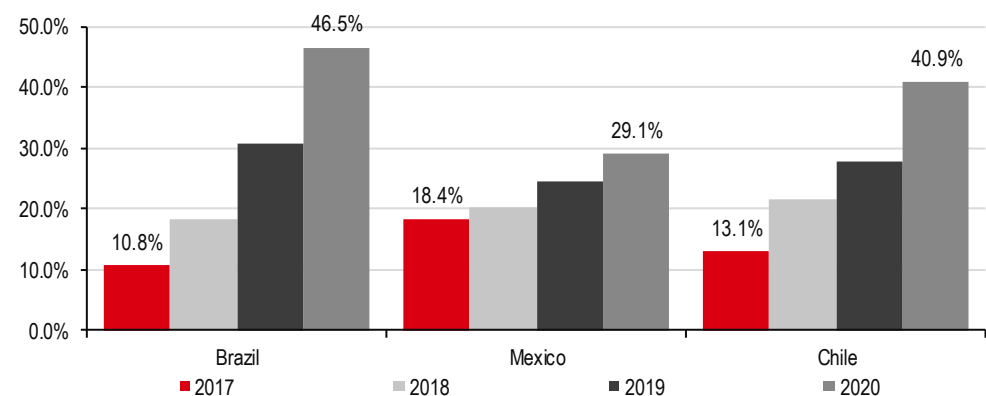
Analyzing the 5G impact on MENA telecoms, we observe that 5G coverage is quite high in the region, with >90% coverage in parts of KSA, UAE, and Kuwait. However, we do think monetization of 5G is likely still slow, even in MENA, despite reasonably advanced tech adoption levels. This is mainly due to relatively low penetration of 5G-enabled devices and a lack of 5G-specific use cases in the short run. Operators are not really offering 5G-specific packages, though some speed differentiation is part of packages in the UAE. We think that for 5G to be a real driver of earnings, wider industrial adoption and high-speed data consuming products (e.g. driverless cars, air taxis, among others) are needed. We think that 5G can be instrumental in restoring some of the elusive pricing power for the telecoms owing to the mission-critical nature of several end uses in the pipeline.

2. Fixed broadband remains a growth engine, driven by fiber expansion, but strong competition could become a potential pain point

Fiber overbuild remains a major concern, in our view

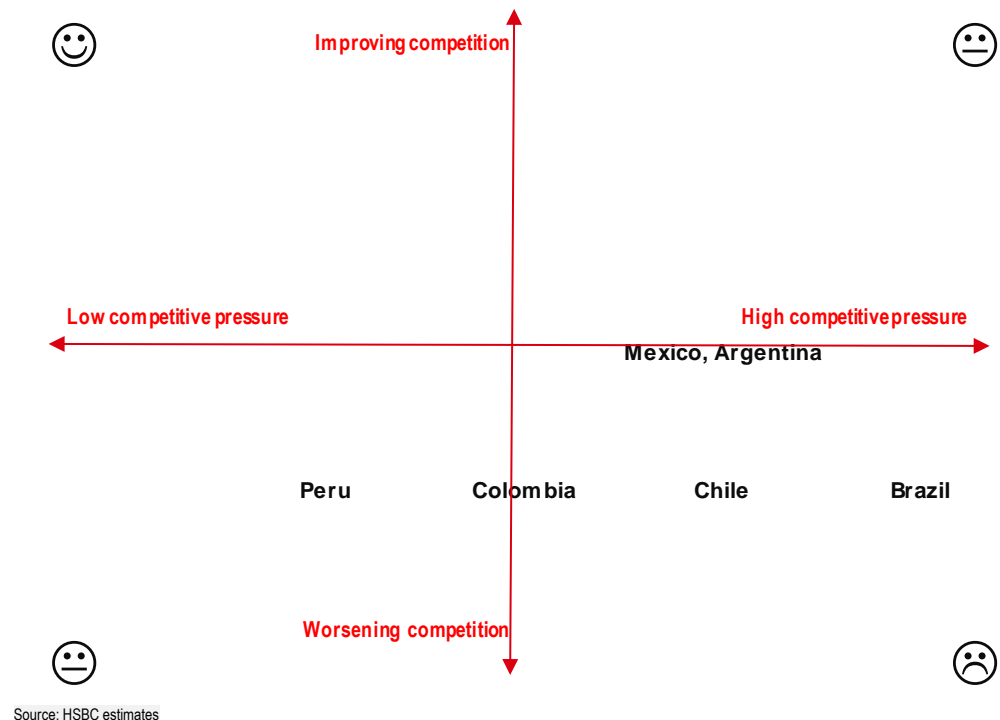
Fixed broadband remains a highly competitive segment, with new fiber operators challenging the incumbents. Over the past 10 years, fixed broadband penetration has grown by high single digits or higher across LatAm. The decreasing cost of fiber deployment has led to aggressive investments by competitors and incumbents. In Brazil, Telefónica Brasil has increased its fiber footprint coverage target to 29m (c40% of Brazilian homes) from 24m, while V.tal, a fiber infrastructure company carved out from Oi, expects to cover 32m homes by 2025 (c44% of Brazilian homes) from 13.5m homes currently. The aggressive fiber expansion by the Brazilian incumbents, Oi and Telefónica Brasil, is likely to compete with smaller operators, which have cumulated c60% fiber broadband market share. Megacable in Mexico and VTR in Chile are cable operators who are aggressively investing in fiber to better compete with new fiber operators on fixed broadband. The expansion of fiber has been driven by decreasing costs of deploying fiber. Telefónica Brasil has reported that the cost of deployment per FTTH homes declined to BRL160 in 2021 (from BRL500 in 2017). The aggressive expansion of fiber across LatAm has worried investors. Fiber overbuild by operators may ultimately result in hurting fiber economics.

Exhibit 2 - Fiber as a percentage of total broadband connections continues its upward trajectory across LatAm



Source: Telecom regulators, HSBC

Exhibit 3 - Fixed broadband competitive environment: Brazil currently looks to have the most competitive broadband environment



Impact of M&A/infrastructure monetization, especially in Brazil, will likely be keenly followed

3. Impact of M&A/divestitures/infrastructure monetization are key events to watch

Over the past couple of years, M&A has become a recurring theme in LatAm telecoms and should improve market structures in countries like Brazil and Panama. In LatAm, the monetization of towers and fiber assets are improving the balance sheets of telecom companies either by providing upfront cash for a stake, reducing net debt, or removing the need for high capex in the future. The impact of these events on returns on investment, dividends, and net leverage is likely to be major driver of share price in the next few years.

The future of Telefónica HispAm operations is key for the evolution of competition

4. The future of Telefónica ex-Brazil is key to the evolution of competition across the region

Apart from América Móvil, Telefónica is the only operator with a pan-LatAm presence. Telefónica has categorized HispAm (LatAm excluding Brazil) operations as non-core and is willing to monetize these assets. Telefónica has, to-date, sold fiber operations in Chile and Colombia, and operations in Central America, and returned spectrum in Mexico to the state citing high spectrum fees.

It is worth noting that the last phase of intense competition in the LatAm mobile environment in 2014-18 was partially caused by the sale of Nextel operations in Mexico, Chile, and Peru, which allowed new entrants to challenge established operators. Nextel was a sub-scale operator using i-Den technology, which was fast becoming obsolete.

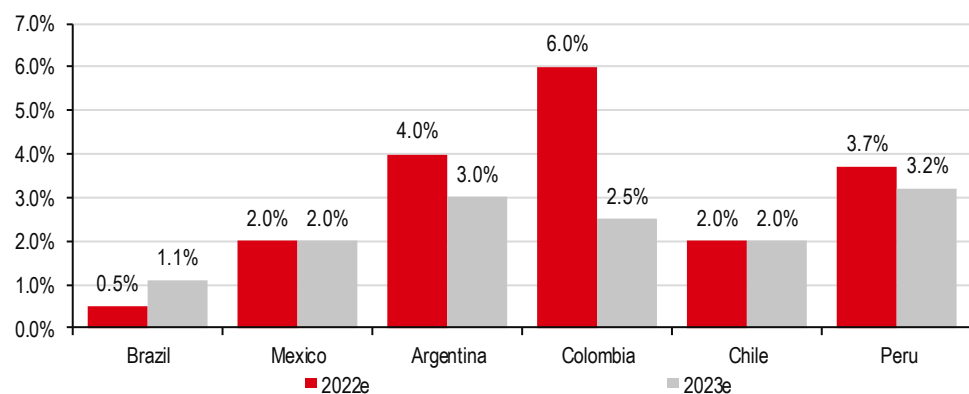
Unlike Nextel, Telefónica is a key operator in major LatAm countries. Telefónica has lost the most market share in markets like Chile and Peru as a result of new entrants. We think that any eventual outcome that could inject significant investments/capital in Telefónica HispAm assets could increase competition for LatAm telecoms.

5. Macro evolution and political outcomes will likely be keenly watched by investors

One of the major concerns for investors is the evolution of the LatAm economies and subsequent impact on equity markets. HSBC's economics team expects economic growth across the region to remain weak. They expect Brazil, the largest economy in LatAm, to grow by 0.5% in 2022e, while Mexico is expected to grow by 2.0%. In addition, the elections in Colombia and Brazil could create an overhang for share prices in these countries.

Inflation across LatAm countries increased significantly in 2021. The geopolitical developments so far in 2022 and the subsequent increases in oil and commodity prices have pushed inflation higher, according to HSBC's economics team. They predict that inflation in 2022 will start to come down in 2H22 in countries like Brazil, Chile; however, any uptick in inflation could hurt the margins of LatAm telecoms.

Exhibit 4 - HSBC economics team predicts low GDP growth in Brazil for the next two years



Source: HSBC estimates

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