

**Credit Opinion: Telenor ASA**

Global Credit Research - 18 Dec 2012

Oslo, Norway

**Ratings**

Category	Moody's Rating
Outlook	Stable
Sr Unsec Bank Credit Facility	A3
Senior Unsecured	A3
Commercial Paper	P-2

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**Key Indicators**

[1]Telenor ASA

	9/30/2012(L)	12/31/2011	12/31/2010	12/31/2009	12/31/2008
Scale (USD Billion)	\$17.3	\$17.6	\$15.7	\$14.5	\$17.3
EBITDA Margin	35.4%	35.1%	34.0%	36.4%	33.5%
Debt / EBITDA	1.9x	1.7x	1.7x	1.6x	2.2x
FCF / Debt	-4.6%	8.7%	12.4%	29.8%	1.3%
RCF / Debt	22.5%	33.4%	34.6%	50.7%	27.8%
(FFO + Interest Expense) / Interest Expense	8.0x	9.2x	9.5x	9.5x	7.9x
(EBITDA - Capex) / Interest Expense	4.6x	5.5x	5.6x	5.5x	3.4x

[1] All ratios are calculated using Moody's standard accounting adjustments. Source: Moody's Financial Metrics

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

**Opinion**

**Rating Drivers**

- Highly diversified business model with good execution track record in emerging markets: strong domestic position, but exposure to India, with a significant amount of uncertainty
- Conservative financial policy supported by stable operating performance and excellent liquidity management
- Government's implicit support and supervision enhances credit profile

**Corporate Profile**

Telenor (A3 stable) is the leading integrated telecommunications provider in Norway, and delivers a full range of services and products, including mobile and fixed-line telephony, broadband and datacom services for residential and business customers, as well as a broad range of wholesale services. Telenor is also a leading provider of

television and broadcasting services in the Nordic region.

In addition, Telenor is one of the leading international providers of wireless services, reporting around 151 million mobile subscribers worldwide (357 million including VimpelCom Ltd, rated Ba3 stable, in which Telenor has a 35.7% economic and 43% voting stake and does not consolidate), as of 30 September 2012. Telenor's activities outside its home market include mobile and fixed operations in Sweden and Denmark, and mobile operations in Hungary, Serbia, Montenegro, Thailand, India, Malaysia, Bangladesh and Pakistan. Additionally, the group is indirectly present in a further 18 markets through its ownership stake in VimpelCom Ltd.

### **Rating Rationale**

Telenor's A3 rating reflects the group's (1) scale; as well as its position as (2) the incumbent integrated player in its domestic market; and (3) a geographically diversified leading mobile telephony operator. Telenor has maintained a solid performance over the past few years and proven to be resilient to the current global economic crisis.

Management intends to keep a conservative financial ratio profile that supports a well-diversified international footprint with significant exposure to emerging market risk. The rating also factors in Telenor's continued strong cash flow generation and management's focus on preserving a strong credit profile through a balanced approach between shareholder remuneration and bondholder protection.

Telenor is a government-related issuer (GRI) and our assessment of the group is based on a combination of its underlying credit strength (a baseline credit assessment, or BCA, of 8, equivalent to a rating of baa1) and our joint default analysis for GRIs. The final rating of A3 benefits from one notch of uplift as a result of the Norwegian government's ownership and our assessment that there is low default dependence between the group and the state and a low likelihood of government support.

### **DETAILED RATING CONSIDERATIONS**

#### **SCALE, LEADING MARKET POSITIONS, INTEGRATED BUSINESS MODEL AND GEOGRAPHICAL DIVERSIFICATION UNDERPIN TELENOR'S RATINGS**

With revenues of NOK75.7 billion (EUR10.2 billion) in the nine months to September 2012, Telenor is the eighth-largest European telecom operator, after Telefónica (Baa2 negative), Deutsche Telekom (Baa1 stable), Vodafone (A3 stable), France Télécom (A3 negative), Telecom Italia (Baa2 negative), BT Group (Baa2 positive) and KPN (Baa2 on review for downgrade). Telenor benefits from economies of scale given its (1) dominant position in the Norwegian market; (2) leading positions within the rest of the Nordics; and (3) diversification into Eurasia, which offsets the risks from an economic downturn in its core markets and provides an engine for growth.

Telenor has an integrated business model in Norway but the group is also an emerging mobile operator in markets such as Bangladesh, Thailand, India and Pakistan, which have high potential growth. We recognise Telenor's efforts to pursue growth opportunities through its geographic diversification in the Asian market.

Telenor has recently acquired spectrum in the Indian 1800 Mhz auctions for INR40.2 billion (NOK4.2 billion, or EUR0.6 billion), in order to reinforce its presence in that market. With a population of approximately 600 million in the awarded areas and mobile phone customer penetration of just 50% according to the company, the awarded spectrum presents a strong growth opportunity for Telenor. The cost is reasonable and confirms management's commitment to maintaining a peak funding threshold in its Indian operations of INR155 billion (EUR2.2 billion) total investment, out of which INR131 billion (EUR1.8 billion, including the newly acquired spectrum) has already been invested in this fast-growing emerging market.

This transaction will, over time, add to Telenor's market share in India, which, according to Telenor, was just under 10% at the end of September 2012 in the areas where the group was awarded new licences.

India accounts for around 5% of Telenor's revenues and has not yet reached the EBITDA breakeven level. Critical to the positive credit implications of the purchase is our expectation that the Indian business will lead to breakeven EBITDA in 2013 or 2014 at the latest and will become a self-funding operation.

Telenor holds significant market shares in most of the markets in which it operates. As of 31 December 2011, the group had a leading position in mobile telephony in Norway, with a 50% market share in terms of subscribers. It also held strong positions in Denmark, where its share of subscribers was 26% (second highest), Bangladesh (44%), Hungary (32%), Serbia (35%) and Montenegro (39%). Telenor's position remained weak in Sweden, where it had a 16% market share (third highest), and moderate in Pakistan (24%) and Malaysia (25% share), as these are more fragmented and competitive markets. Telenor aims to maintain leadership in the markets in which it

operates, preserving its position among the top three competitors. Moreover, Telenor has an economic share of 35.7% in VimpelCom Ltd, which offers mobile services in an additional 18 markets.

#### STABLE AND PRUDENT FINANCIAL POLICY

Management's financial risk strategy will directly affect Telenor's debt and credit quality, and is therefore a key rating determinant. The group's main priority for capital allocation is to maintain a solid balance sheet via a reported net debt/EBITDA ratio of below 2.0x (which broadly translates to 2.6x after our adjustments on a gross basis). We have made NOK24 billion of adjustments to Telenor's debt, primarily related to operating leases and pensions, representing around 37% of the group's total adjusted debt as of 30 September 2012.

Although management's attention is currently concentrated on delivering in its established footprint, we believe that the group will continue to look for opportunities to acquire complementary businesses in areas in which it operates. This is based on our expectation that Telenor's M&A strategy will be both very selective and cautious, consistent with the group's medium-term net debt/EBITDA cap. We do not expect that the group will undertake large-scale acquisitions.

While Telenor is committed to a solid investment-grade rating, if it does not identify appropriate acquisition targets, the group could use excess cash for a share buyback programme, such as the 3% buyback it launched in July 2012 (72% completed as of 18 December 2012 for an outflow of NOK 1.7 billion).

#### STRONG AND STABLE OPERATING MARGINS AND CASH FLOW GENERATION

The level and stability of operating margins is a key consideration in assessing risk to debtholders. As a result of a stable economic environment in most of the markets in which Telenor operates, and supported by strong subscription growth in Asia, the group was able to deliver revenue growth in the first three quarters of 2012 of 3.6% (+NOK2.6 billion). The Nordic region continued to benefit from mobile data growth. However, total revenue growth was negatively affected by reduced international roaming fees, negative currency effects and increased competitive pressure. In Asia, where Telenor maintained or improved its market positions, revenues from the group's established operations grew by 6% (organic, excluding India). We expect that Telenor will post organic revenue growth of around 4% for full year 2012.

Telenor's margins are also improving, as a result of the improved performance of the group's established Asian operations. During the first nine months of 2012, the group's reported EBITDA reached NOK24 billion (EUR3.3 billion). This represented a 4.5% increase compared with the same period the previous year and was a result of the enhanced performance of the group's established Asian operations and decreasing losses in India. We would expect Telenor to maintain EBITDA at 35% for 2012.

Net cash inflow from operating activities during the first three quarters of 2012 was NOK19.2 billion (EUR2.6 billion), a decrease of NOK2.1 billion (EUR0.3 billion) compared with the first three quarters of 2011. The decline is mainly explained by less positive changes in working capital and lower dividends from associated companies. We expect a gradual improvement for 2013 and 2014 as the negative trends are reversed.

#### Liquidity

Telenor's liquidity profile is more than sufficient to cover its debt maturities and other cash demands, including capital expenditure (capex) of around NOK17 billion (EUR2.3 billion) and dividend payments. As of September 2012, Telenor had around NOK8.9 billion (EUR1.2 billion) in cash and cash equivalents. The group's external liquidity sources, comprising back-stop facilities, are robust, with two committed credit lines amounting to EUR800 million and EUR2.0 billion and maturing in 2017 and 2016, respectively. These facilities are not subject to material adverse change clauses or financial covenants.

We note that there is no significant structural subordination of creditors at the subsidiary level, at which debt makes up around 23% of total group net debt as of Q3 2012.

#### Other Considerations

**Methodology:** In assessing Telenor's standalone credit strength (BCA), we use the Global Telecommunications Industry rating methodology, last updated in December 2010. The grid outcome is Baa1, based on the group's last twelve months results as of 30 September 2012.

**Discussion of GRI inputs:** Telenor is 53.97% owned by the Norwegian government. As a result, the group qualifies as a GRI under our GRI methodology, last updated in July 2010. Telenor's A3 rating reflects the combination of the

following inputs:

The group's BCA of 8 (equivalent to baa1, on a scale of 1 to 21, where 1 represents the lowest level of credit risk), reflecting its leading positions in the Nordic market for wireline and wireless services combined with its international footprint. The BCA does not incorporate any further major event risk in the form of M&A activity in the short to medium term.

The low level of default dependence between Telenor and the government. This reflects the weak correlation between Telenor's credit profile and Norwegian economic trends, which is mainly a result of the group's strong liquidity and increasing market diversity. More specifically, our assessment that there is a low level of default dependence between Telenor and the government is based on the lack of financial and operational links between the two. This reflects our view that telecoms operators generally have a fairly low level of correlation with the sovereign. In particular, we observe that direct and indirect fiscal transfers and government telecom expenditure represent a low proportion of Telenor's revenue. More generally, Telenor and the government are not exposed to the same revenue base and do not share the same credit risks (around 30% of Telenor's revenues are generated in Norway).

The low level of government support available to Telenor in the event of need, based on the following observations:

There is no explicit support from the government. Also, we are not aware of any formal verbal or written confirmation that the government will support Telenor in the event of a default on its financial debt. In addition, Telenor does not have any special legal status that would suggest a closer link with the state or an implicit form of support.

The government's 53.97% ownership of Telenor and its willingness to behave as a rational shareholder suggests that the government would be unlikely to be the sole provider of support. Instead, it would likely only consider providing support jointly with other shareholders in the form of a capital increase. Although Parliament has approved a possible reduction in the state ownership of Telenor to 34% in the event of a strategic transaction, we are not aware of any plans for further privatisation.

There are EU policy barriers to the provision of direct financial support and the government is likely to obey these rules.

We consider the Norwegian government to be non-interventionist, despite holding significant ownership stakes in several companies.

In our view, it is unlikely that the government's good reputation would be damaged in the event of a default by Telenor.

Telenor's economic and social importance in Norway has diminished over recent years. This is a result of the increasing presence of viable, privately owned competitors with significant market share and the group's presence in emerging markets.

## **Rating Outlook**

The stable outlook reflects our expectation of a progressive improvement in Telenor's financial ratios. We expect that the group will exhibit adjusted retained cash flow (RCF)/debt of around 35% and debt/EBITDA of below 2.5x over the next couple of years.

## **What Could Change the Rating - DOWN**

Negative rating pressure could develop if Telenor's adjusted RCF/debt ratio were to deteriorate to the low 30s in percentage terms for a sustained period of time and its adjusted debt/EBITDA ratio were to approach 3.0x. Further meaningful investments in emerging market assets would also exert negative pressure on Telenor's current ratings, even without considering the impact of such investments on the group's credit metrics.

## **What Could Change the Rating - Up**

To consider upgrading Telenor, we would require evidence of the group performing consistently within the guidance for an upgrade. This would include (1) an adjusted RCF/debt ratio that is sustained in the high 30s in percentage terms; and (2) an adjusted debt/EBITDA ratio that is consistently and comfortably below 2.0x.

In addition to the factors listed above affecting Telenor's BCA, the group's ratings could be affected by changes in

the ratings of the supporting government, or changes in our assessment of default dependence and support, described in the Other Considerations section.

## Rating Factors

### Telenor ASA

Global Telecommunications Industry [1][2]	Aaa	Aa	A	Baa	Ba	B	Caa
<b>Factor 1: Scale And Business Model, Competitive Environment And Technical Positioning (27%)</b>							
a) Scale (USD Billion)			\$17.3				
b) Business Model, Competitive Environment and Technical Positioning			x				
<b>Factor 2: Operation Environment (16%)</b>							
a) Regulatory and Political				x			
b) Market Share			x				
<b>Factor 3: Financial Policy (5%)</b>							
a) Financial Policy				x			
<b>Factor 4: Operating Performance (5%)</b>							
a) EBITDA Margin				35.4%			
<b>Factor 5: Financial Strength (47%)</b>							
a) Debt / EBITDA			1.9x				
b) FCF / Debt							
c) RCF / Debt					22.5%		
d) (FFO + Interest Expense) / Interest Expense			8.0x				-4.6%
e) (EBITDA - Capex) / Interest Expense				4.6x			
<b>Rating:</b>							
a) Indicated Rating from Grid				Baa1			
b) Actual Rating Assigned			A3				

[1] All ratios are calculated using Moody's standard accounting adjustments. [2] As of 9/30/2012(L); Source: Moody's Financial Metrics



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