MOODY'S
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Credit Opinion: Telenor ASA

Global Credit Research - 23 Dec 2014

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**

	12/31/2013	12/31/2012	12/31/2011	12/31/2010
Scale (USD Billion)	**$17.7**	**$17.5**	**$17.6**	**$15.7**
EBITDA Margin	**37.2%**	**36.1%**	**35.1%**	**34.0%**
Debt / EBITDA	**2.0x**	**1.9x**	**1.7x**	**1.7x**
FCF / Debt	**11.5%**	**-9.8%**	**8.7%**	**12.4%**
RCF / Debt	**34.6%**	**16.2%**	**33.4%**	**34.6%**
(FFO + Interest Expense) / Interest Expense	**13.1x**	**7.9x**	**9.2x**	**9.5x**
(EBITDA - Capex) / Interest Expense	**6.3x**	**4.8x**	**5.5x**	**5.6x**

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. 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 geographically diversified business profile with good execution track record in emerging markets

- Leading market positions in most of the company's markets

- High capex investment policy to continue to support network development in emerging markets

- Conservative financial policy, supported by stable operating performance and excellent liquidity management

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 mobile services, reporting around 179 million mobile subscribers worldwide as of September 2014. 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 14 markets through its ownership stake in VimpelCom Ltd (Ba3 stable), in which Telenor has a 33.05% economic share and a 43% voting share, which it does not consolidate.

SUMMARY 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; (3) a geographically diversified leading mobile telephony operator; in addition to the group's (4) solid and stable operating performance; and (5) excellent liquidity management. 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, high capex investment policy 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 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, INTEGRATED BUSINESS MODEL AND GEOGRAPHICAL DIVERSIFICATION UNDERPIN TELENOR'S RATINGS

Telenor's rating reflects its large scale (revenues of NOK81.0billion (EUR9.0 billion) in the nine months to September 2014) and the diversification benefits associated with its strong market positions in many different countries. 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 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 also operates in India (where Telenor has full ownership of Telewings, after the increase of its ownership from 74% to 100% in October 2014), where it operates under the brand name Uninor. Telenor's Indian business is present in six circles (out of 23) with a total population of around 600 million people, reaching around 50% of population coverage (from 42% in 2013). We expect that the company will reach its EBITDA breakeven level in 2015. We expect that Telenor's operations in India, which account for around 4% of the company's revenues, will benefit from strong growth in over the medium term.

In addition, in July 2013, Telenor was pre-qualified for the competition to win one of two nationwide telecommunications licences in Myanmar. Telenor Myamnar was commercially launched at the end of September 2014 and has already passed one million subscribers. However, and although the company is targeting EBITDA breakeven within 3 years from licence award, we believe this greenfield project involves an uncertain capital commitment and long-dated returns.

LEADING MARKET POSITIONS IN MOST OF THE COMPANY'S MARKETS

Telenor holds significant market shares in most of the markets in which it operates. In Norway, Telenor is the market leader in the fixed-line business, where it holds a market share (as reported by the company) of around 65%, broadband with around 46% market share (estimated by the company) and mobile with some reported market share of 50%. We expect a relative quiet period in terms of mobile competition, as Tele 2 and TeliaSonera are somewhat focusing on completing the merger, which could detract from their commercial efforts. The development, however, may eventually result in newly TDC acquired cable operator Get launching an MVNO based mobile operation through an agreement with wireless broadband player Ice, which has acquired mobile spectrum.

On 3 December 2014, Telenor announced that it has agreed with TeliaSonera to merge their Danish mobile operations into a new 50-50 joint venture. We view this merger as credit positive as it will reduce the number of mobile operators in the market to three from four and the merged company will be similar in size to the market leader (TDC, Baa3 stable).

Telenor also holds strong positions Bangladesh (42%), Hungary (31%), Serbia (36%) and Montenegro (39%). Telenor's position remains weak in Sweden, where it has a 17.1% reported market share (third highest as reported by the company), and moderate in Pakistan (market share of 25% reported by the company) and Malaysia (market share of 26% reported by the company), as these are more fragmented and competitive markets. In Thailand, competition remains intense, with pricing competition spreading from voice to data and although there are some signs that the macro economy is improving, the operating performance remains weak.

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 33.0% in VimpelCom Ltd, which offers mobile services in an additional 14 markets.

HIGH CAPEX INVESTMENT POLICY

Telenor invested NOK16.2 billion (EUR1.7 billion) for the nine-month period to September 2014, particularly in Norway (18.6% of total capex), owing to continued 4G network roll-out at high speed (with a current population coverage of 80%) and fibre footprint; and Myanmar (22.6% of total capex) owing to the development of a fixed network infrastructure in the country.

In India, Telenor started the redeployment of 5,000 sites from exited circles started in January 2014. As of 30 June, around 1,300 sites had been redeployed, with around half of the budgeted capex for India dedicated to the redeployment programme.

We note that Telenor has been undertaking substantial capex in the past (expected capex over sales of 18% for 2014) and we expect that this high investment policy will continue into 2015.

STABLE AND PRUDENT FINANCIAL POLICY

Telenor follows a balanced financial policy between shareholders and creditors. 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 competitive dividend policy of 50%-80% of normalised net income and 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 NOK20.6 billion (EUR2.2 billion) of adjustments to Telenor's debt, primarily related to operating leases and pensions, representing around 24% of the group's total adjusted debt as of December 2013.

Although management's attention is currently concentrated on delivering in its established footprint, we expect that the group will continue to look for opportunities to acquire complementary businesses in areas in which it operates. Our expectation is based on our view that Telenor's M&A strategy will likely be 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, maintaining adjusted gross debt/EBITDA at around 2.0x for this year and below 1.8x in the medium term.

STRONG AND STABLE OPERATING MARGINS AND CASH FLOW GENERATION

The level and stability of operating margins is a key consideration in assessing risk to debt holders. 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 and customer uptake in India, Bangladesh, Malaysia and Myanmar, the group was able to deliver revenue growth in the first three quarters of 2014 of 6% compared with the same period last year. The group benefited from higher revenues in all the business segments except for Denmark, which is affected by a challenging operating environment (expected to improve after the merger) and Thailand, which was severely affected by lower interconnection rates. We expect that Telenor will record revenue growth of around 4% for full year 2014 and mid-single digit growth in 2015 and 2016.

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 2014, the group's reported EBITDA reached NOK29.2 billion (EUR3.1

billion). This represents an 8.5% increase compared with the same period the previous year and was a result of the enhanced performance of the group's established Asian operations, decreasing losses in India and gross opex savings, mainly in Norway, where the company has implemented a cost savings program of some NOK2 billion in 2013-15. We would expect Telenor to maintain EBITDA of around 35% in the medium term.

In addition, Telenor has been delivering in terms of operating cash flow generation, with negative trends reversing, particularly in India. Net cash inflow from operating activities during the first three quarters of 2014 was NOK27.8 billion (EUR3.0 billion), a decrease of NOK2.0 billion compared with the first three quarters of 2013. This is mainly explained by a NOK6.5 billion reduction in dividends received from VimpelCom Ltd. This effect was partially offset by higher EBITDA before other items of NOK2.3 billion, lower income tax paid of NOK1.3 billion, and improved working capital by NOK0.7 billion. We expect the company's retained cash flow (RCF) to debt ratio to be sustained around 30% in the medium term.

Liquidity Profile

Telenor's liquidity profile is more than sufficient to cover its debt maturities and other cash demands, including capital expenditure (capex) of around NOK18 billion (EUR2.1 billion) and dividend payments. As of September 2014, Telenor had around NOK13.2 billion (EUR1.5 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 2019, 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 22% of total group net debt as of September 2014.

Rating Outlook

The stable rating outlook reflects the strength of Telenor's financial ratios. We expect that the group will exhibit adjusted retained cash flow (RCF)/debt of around 30% and debt/EBITDA of below 2.0x 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 effect of such investments on the group's credit metrics.

What Could Change the Rating - Up

To consider upgrading Telenor's rating, 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.

Other Considerations

METHODOLOGY GRID

In assessing Telenor's credit quality, we apply the Moody's Global Telecommunications Industry rating methodology. In terms of the methodology grid, the A2 grid outcome for Telenor, which is one notch higher than the A3 rating, reflects the company's leading positions in the Nordic market for wireline and wireless services and its international footprint. The difference incorporates the risk of operating in emerging markets and greenfield challenges, as well as some M&A activity.

We expect that Telenor's credit metrics will remain broadly stable in the next 12 months except for the cash flow, which will slightly deteriorate after the reduction in dividends received from Vimpelcom. Overall, we expect the group's global revenue to increase in 2015 and 2016 and adjusted EBITDA margin close to 40%. We expect adjusted RCF/ debt in the 27%-30% range and free cash flow (FCF)/ debt below 4%, as high investment to continue. We also anticipate funds from operations (FFO) coverage in the 10x-11x range and (EBITDA - Capex)/Gross interest expense between 6.0x and 8.0x. In terms of leverage, we expect adjusted gross debt/EBITDA at around 2.0x for this year and below 1.8x in the medium term.

GOVERNMENT-RELATED ISSUER (GRI) INPUTS

Telenor qualifies as a GRI under our methodology for such entities because it is 53.97% government owned. Therefore, Telenor qualifies as a GRI under Moody's GRI methodology. Our A3 rating for Telenor reflects the combination of the following GRI inputs: (1) a BCA of baa1; (2) the Aaa (stable outlook) local currency rating of the Government of Norway; (3) low default dependence; and (4) the likelihood of the government providing a low level of support to the company in the event of need.

The low level of default dependence between Telenor and the government 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 24% of Telenor's revenues are generated in Norway).

Our assessment that there is a low level of government support available to Telenor in the event of need is based on the following observations: (1) There is no explicit support from the government; (2) 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; and (3) 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 Factors

Telenor ASA

Global Telecommunications Industry Grid [1][2]	**12/31/2013**		[3]**Moody's 12-18 Month Forward View**	
Factor 1: Scale And Business Model, Competitive Environment And Technical Positioning (27%)	**Measure**	**Score**	**Measure**	**Score**
a) Scale (USD Billion)	$17.7	A	$18.0-$20.0	A
b) Business Model, Competitive Environment and Technical Positioning	Aa	Aa	Aa	Aa
Factor 2: Operation Environment (16%)				
a) Regulatory and Political	Baa	Baa	Baa	Baa
b) Market Share	A	A	A	A
Factor 3: Financial Policy (5%)				
a) Financial Policy	A	A	A	A
Factor 4:Operating Performance (5%)				
a) EBITDA Margin	37.2%	Baa	38.0%-40%	Baa
Factor 5: Financial Strength (47%)				
a) Debt / EBITDA	2.0x	A	1.8x-2.0x	A

b) FCF / Debt	11.5%	Caa		<4%	Caa
c) RCF / Debt	34.6%	Baa		27%-30%	Baa
d) (FFO + Interest Expense) / Interest Expense	13.1x	Aaa		10.0x-11.0x	Aa
e) (EBITDA - Capex) / Interest Expense	6.3x	A		6.0x-8.0x	A
Rating:					
a) Indicated Rating from Grid		A2			A2/A3
b) Actual Rating Assigned					A3

Government-Related Issuer	Factor
a) Baseline Credit Assessment	baa1
b) Government Local Currency Rating	Aaa
c) Default Dependence	Low
d) Support	Low
e) Final Rating Outcome	A3

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 12/31/2013; Source: Moody's Financial Metrics [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.