

Research Update:

Telenor Downgraded To 'A-/A-2' On Debt-Financed DNA Deal And Weaker-Than-Expected Performance In Asia; Outlook Stable

September 9, 2019

Rating Action Overview

- Norway-based telecommunications operator Telenor ASA has leaned on debt to finance its acquisition of a 54% stake in Finnish telecom operator DNA for €1.5 billion and to launch a mandatory tender offer for DNA's remaining shares for another €1.3 billion.
- At the same time, Telenor's weaker-than-expected operating performance in Asia, notably Thailand, has led us to revise down our EBITDA estimates, with S&P Global Ratings-adjusted debt to EBITDA, depending on the final ownership in DNA, between 2.2x and 2.6x in 2019-2020.
- We are consequently lowering our long- and short-term issuer credit ratings on Telenor to 'A-/A-2' from 'A/A-1', and our issue ratings on Telenor's debt to 'A-' from 'A'. We have removed all ratings on Telenor and its debt from CreditWatch with negative implications, where we placed them on April 10, 2019.
- The stable outlook reflects our anticipation that Telenor's organic EBITDA and free operating cash flow (FOCF), excluding spectrum, will stabilize in 2020, after a dip in 2019, with adjusted debt to EBITDA at around 2.5x.

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Rating Action Rationale

The downgrade follows Telenor's ongoing, debt-financed acquisition of DNA and, to a lesser extent, our lower EBITDA estimates for 2019-2020 on weaker-than-expected performance in Asia. We now project Telenor's S&P Global Ratings-adjusted debt to EBITDA remaining between 2.2x and 2.6x in the coming years, which also reflects Telenor's 1.5x-2.0x reported leverage target. This level is commensurate with our 'bbb+' stand-alone credit profile assessment, versus our previous 'a-' assessment. These developments do not change our assumption that Telenor would benefit from a moderate likelihood of timely and sufficient extraordinary government support from Norway if needed.

On Aug. 21, 2019, Telenor acquired 54% of DNA for €1.5 billion (approximately Norwegian krone

[NOK] 15 billion). About a week later, the company launched a mandatory tender offer to acquire the remaining shares in DNA for about €1.3 billion. This debt-funded acquisition, coupled with our expectation of negative discretionary cash flow (DCF) after annual dividends of NOK15 billion-NOK18 billion and about NOK7 billion in annual share buybacks, will result in Telenor's debt, as adjusted by S&P Global Ratings, increasing steadily to between NOK110 billion and NOK130 billion in the next two years, from NOK82 billion in 2018.

Although we forecast a temporary dip in performance in Asia, Telenor's presence in Asia continues to support the company's creditworthiness. Telenor generates about 60% of its EBITDA in Asia, and growing EBITDA in the region in the long term, given a lower smartphone penetration and weaker fixed telecommunication infrastructures than in Telenor's Nordic markets, should translate in rising mobile data consumption. However, in Asia, Telenor is exposed to meaningful country risks, including potential volatility tied to economies and currencies, as well as regulatory risks, and severe competition. Telenor is No. 1 in Bangladesh, No.2 in Myanmar, and No. 3 in Thailand, Pakistan, and Malaysia. We also note that Telenor is experiencing heavy pricing pressure on the prepaid voice segments, typically still a large part of the mobile markets (for instance 50% in Thailand).

We have lowered our estimate of Telenor's 2019 EBITDA due to:

- A 15% EBITDA year-on-year decline in Thailand (12%-13% of Telenor's consolidated EBITDA) where the transition from the concession model to a license model in September 2018 continues to weigh on financial performance, including lower EBITDA and higher capital expenditure (capex) following the switch to its own network.
- Roughly flat EBITDA in Malaysia (12%-13% of total EBITDA) after a 2-3% revenue decline in the 1st 6 months of 2019 on continued decline in prepaid voice.
- A NOK0.3 billion provision made in Bangladesh relating to commission payment and weaker performance in Pakistan in second-quarter 2019.

Outlook

The stable outlook reflects our anticipation that Telenor's organic EBITDA and FOCF (excluding spectrum) will stabilize in 2020, after a dip in 2019. We also consider that the company's adjusted debt to EBITDA will remain between 2.2x and 2.6x in the next 24 months.

Downside scenario

We could lower the rating if adjusted debt to EBITDA exceeded 2.8x or funds from operations (FFO) to debt declined below 25%. This could be caused by waning performance in several markets, alongside reported leverage in the upper range of its 1.5x-2.0x target.

Upside scenario

We could raise the rating if Telenor reported sustainable growth and profitability in all markets, while maintaining adjusted debt to EBITDA of less than 2x and FFO to debt of more than 40%. We view this as unlikely, however, given the parameters of the group's current financial policy.

Company Description

Telenor is the leading Norwegian provider of fixed-line and mobile telecom services, with a portfolio of mobile and fixed assets in Scandinavia, and mobile assets in South and Southeast Asia. The group also provides television broadcasts, information technology, and Internet services in the Nordic region.

Our Base-Case Scenario

- Low single-digit decline or flat organic group service revenues over 2019-2021, with positive growth in Norway from customers trading up to FttH and sound mobile, and solid growth in Bangladesh offset by negative top-line in mature Asia, Myanmar, and Denmark. In Norway, we foresee that slight mobile and fixed broadband revenue growth will be offset by declining fixed voice.
- An 8% positive scope impact from the assumed full consolidation of DNA over the coming 12 months.
- S&P Global Ratings-adjusted IFRS16 EBITDA margin of about 43%-44% in 2019-2021, slightly up from about 42% in 2018-2017 due to IFRS16 impacts, cost optimization and the consolidation of DNA, mitigated by weakness in several Asian markets in particular Thailand.
- Overall capex at about 15% of revenues excluding frequencies, and high, albeit less predictable, spectrum outlays of about NOK7 billion annually on average over 2019-2021 to sustain Telenor's focus on high-end data-hungry customers.
- Staggered proceeds from previous Central Eastern European asset disposals (NOK1 billion per year).
- About NOK15 billion-NOK18 billion in annual dividends, including to minority shareholders in partly-owned subsidiaries.
- About NOK7 billion in annual share buybacks.

Based on these assumptions, we arrive at the following credit measures:

- Adjusted leverage at least at 2.2x in 2019 and 2.4x in 2020 (assuming a 54% stake in DNA), or 2.4x and 2.6x in the same period (assuming 100% ownership of DNA).
- FFO to debt between 30% and 35% in 2019 and 2020.
- FOCF to debt (excluding spectrum) between 18% and 21% in 2019 and 2020.

Liquidity

Our assessment of Telenor's liquidity as adequate particularly points to our projection that the company's sources of liquidity will cover uses by more than 1.2x over the 12 months from end-June 2019. Furthermore, we think the company has a generally satisfactory standing in credit markets, sound relationships with its banks, and generally prudent risk management. We have based our assessment on a group-wide approach.

Below, our estimates of Telenor's main liquidity sources and uses for the 12 months started June 30, 2019:

Principal Liquidity Sources

- About NOK27 billion at parent, pro forma deducting the acquisition price (about NOK15 billion) of the 54% stake in DNA;
- A €2 billion undrawn committed long-term revolving credit facility (NOK20 billion) maturing in 2021;
- FFO of about NOK42 billion;
- About NOK1 billion of staged proceeds from the previous Central Eastern European assets disposal; and
- Holdings of VEON shares worth about NOK5.2 billion at end-2018.

Principal Liquidity Uses

- Short-term debt of NOK17 billion at end-June 2019 (including the \$1 billion bond exchangeable into VEON shares);
- Capex of about NOK23 billion including spectrum acquisition; and
- Dividends of about NOK16 billion, including dividends to minority shareholders in partly-owned subsidiaries.

Ratings Score Snapshot

Issuer Credit Rating: A-/Stable/A-2

Business risk: Strong

- Country risk: Intermediate
- Industry risk: Intermediate
- Competitive position: Strong

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bbb+

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb+

- Related government rating: AAA

- Likelihood of government support: Moderate (+1 notch from SACP)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Telecommunications And Cable Industry, June 22, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Telenor ASA, July 1, 2019
- Norway-Based Telecom Operator Telenor 'A/A-1' Ratings Placed On CreditWatch Neg On Debt-Financed Acquisition Plans, April 10, 2019

Ratings List

Downgraded; Outlook Action

	To	From
Telenor ASA		
Issuer Credit Rating	A-/Stable/A-2	A/Watch Neg/A-1
Telenor ASA		
Senior Unsecured	A-	A/Watch Neg
Commercial Paper	A-2	A-1/Watch Neg

Downgraded; Outlook Action

	To	From
Telenor East Holding II AS		
Senior Unsecured	A-	A/Watch Neg

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