S&P Global Ratings

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Summary:

DNA PLC

Primary Credit Analyst:
Sandra Wessman, Stockholm (46) 8-440-5910; sandra.wessman@spglobal.com

Secondary Contact:
Thierry Guermann, Stockholm (46) 8-440-5905; thierry.guermann@spglobal.com

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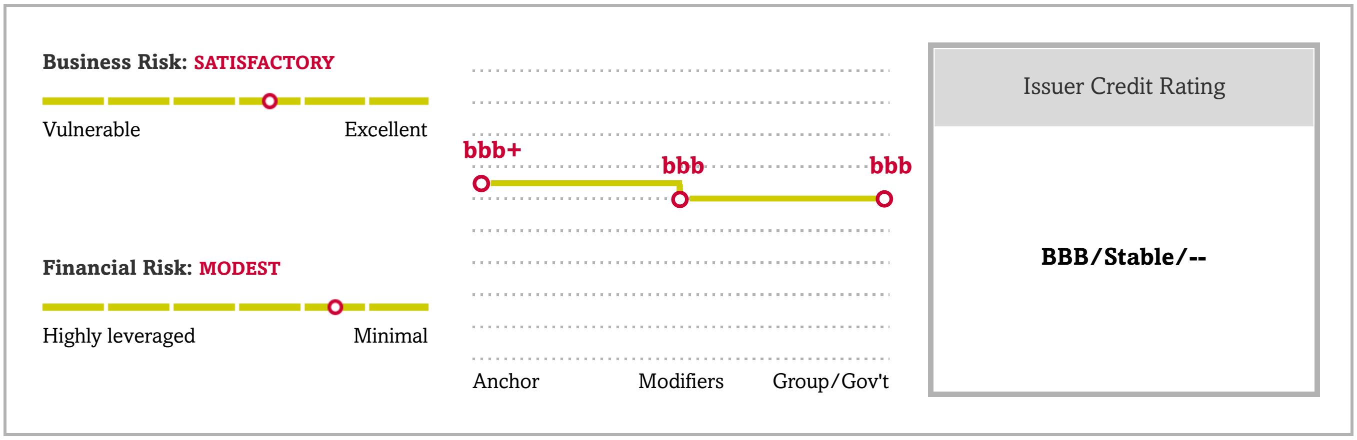

Rationale

Business Risk: Satisfactory	Financial Risk: Modest
• Increasing market shares, No. 1 in the Finnish pay-TV market with a 35% share, No. 2 fixed broadband operator with a 28% market share, and No. 3 mobile operator with 27%. • Largest hybrid-fiber-coaxial network in Finland covering 850,000 households, therefore well positioned to strengthen fixed broadband revenues. • Well-invested mobile network, with 4G coverage for 99.7% of the Finnish population. • A stable competitive environment in the Finnish telecom market with three main players. • Relatively small absolute scale with annual EBITDA of about €300 million and no geographic diversification outside Finland. • Local competition from two larger players, Elisa and Telia (consolidated turnover 2x and 10x larger, respectively).	• Healthy balance sheet position, with S&P Global Ratings-adjusted debt to EBITDA set to remain well below 2.0x in 2018-2019. • The company's stringent financial policy target of keeping leverage below 2.0x (below 2.25x including our adjustments), which implies that credit ratios could be weaker than in our base case as a result of debt-funded acquisitions or extraordinary shareholder returns. • Strong free cash flow generation of well over €150 million for 2018-2019. • Financial policy aiming to distribute most of the free cash flow to shareholders.

Outlook: Stable

The stable outlook on Finland-based telecommunications services provider DNA PLC reflects our expectation that DNA will deliver organic revenue growth of about 3% and an EBITDA margin of at least 35%, while maintaining S&P Global Ratings-adjusted leverage comfortably below 2.25x and free operating cash flow (FOCF) to debt well above 25%.

Downside scenario

We could take a negative rating action if DNA experienced declining revenues or if its margins started to deteriorate, likely stemming from intensified competition in the Finnish market. We could also take a negative rating action if leverage increased and stayed above 2.25x for a long period or FOCF fell toward 20%, for example owing to a more aggressive financial policy or acquisitions.

Upside scenario

We see rating upside as remote, given DNA's limited scale and diversification, and its financial policy.

Our Base-Case Scenario

Assumptions

- Positive macroeconomic trends in Finland in 2018-2019, with projected real GDP growth of 1.5%-2.5% and consumer price index growth of about 1%.
- Revenue growth of about 3%-4% in 2018-2019, stemming from the upselling of higher mobile data speeds, increasing fixed broadband subscribers, and selective price increases in the consumer segment, balanced by declining revenues on subscriber losses in the terrestrial TV network, secular decline in fixed line telephony, and price pressure in the corporate segment.
- Mobile service revenue growth of 5%-8% in 2018-2019, since we expect that there is headroom for further increases in the average revenue per user (ARPU) following a 9% jump in 2017. We expect DNA to make modest price increases in line with the Finnish market, stemming from continued demand for mobile data and increasing speed.
- S&P Global Ratings-adjusted EBITDA margin of about 38%-39% in 2018-2019, a gradual improvement from 33% in 2015 and 37.3% in 2017, stemming from increasing revenues from high-margin service revenues and scale benefits.
- Capital expenditure (capex) of about 15% of sales in 2018-2019, excluding spectrum.
- Moderate spectrum payments of about €8 million per year in 2018-2019.
- Dividend payments of about €145 million in 2018 and 70%-90% of free cash flow to equity in 2019.

Key Metrics

	2017A	2018E	2019E
Revenue growth (%)	3.2	3.0-3.5	3.0-3.5
EBITDA margin (%)*	37.3	38-39	38-39
Debt/EBITDA (x)*	1.4	1.4-1.6	1.5-1.7
FFO/Debt (%)*	64.4	55-60	50-55
FOCF/Debt (%)*	32.5	28-33	25-30

*S&P adjusted figures. FOCF--Free operating cash flow. A--Actual. E--Estimate.

Company Description

DNA is one of the three telecommunications service providers in Finland with its own nationwide mobile and fixed networks. The key infrastructure assets that enable its services consist of a nationwide 4G mobile network, and a hybrid-fiber-coaxial network, which is the largest in the country based on the number of households covered within its footprint. As of third-quarter 2018, the group has about 2.9 million mobile subscribers and about 480,000 subscribers. DNA's operations are primarily focused on the consumer segment, representing about 77% of the group's EBITDA (against 23% from the corporate business).

Business Risk: Satisfactory

Our assessment of DNA's business risk is supported by the company's increasing subscriber share of the Finnish mobile and fixed broadband market, its well-invested networks, leading position in the Finnish cable-TV market, and relatively stable competitive dynamics in the three-player Finnish telecom market.

A growing number three in a relatively stable market, DNA is the leading pay-TV provider in Finland and has gradually gained market shares in both mobile and fixed broadband business. In mobile, DNA serves 27% of the market's subscribers as of June 2018 and 28% of the fixed broadband subscribers, replacing Telia as the second largest. DNA has steadily increased its market share from about 10% in 2009 and, in our view, is well positioned to increase it further, given its high-quality fixed network. In addition, DNA has a leading position in Finnish cable-TV, with a market share of about 40%, but its subscriber base in its terrestrial network declined by 10% in 2017, in part due to a switch-off of the platform in certain regions.

Well-invested networks result in modest capital expenditures

In mobile, DNA benefits from its 4G network coverage for 99% of the population. Its high-quality cable fixed network provides superior speeds of 1 gigabyte (GB) per second to 620,000 customers out of its coverage area of 850,000 households (33% of households in Finland). This allows DNA to benefit from gradually upselling higher-speed subscriptions. Currently, fixed broadband penetration and average speeds in Finland are below the European average, which is partly due to generous mobile data packages (more than 70% are unlimited). However, we think rising data consumption will stimulate additional demand for high-speed fixed broadband in the coming years. In addition, we consider the competitive environment in this segment to be fairly stable, with only moderate incentives for operators to poach customers outside their own fixed broadband footprint.

The three-player mobile telecom market exhibits rather stable competitive dynamics

In our view, Finland's telecom market has future growth opportunities from well-invested networks and high spectrum availability. Finland has a relatively small population of 5.5 million and relatively low population density compared with that in most European countries, allowing for high data consumption and speed; DNA displays the highest mobile data consumption per subscriber in Europe at 19.8GB per month. However, we also are mindful that the mobile ARPU growth is not as strong as data consumption, reflecting the pricing model, which offers mainly unlimited data consumption with a speed differentiator.

Our assessment of DNA's business risk is constrained by the company's very limited scale, competition from larger players, and geographic diversification, with annual revenues of €886 million in 2017 and a subscriber base that is confined to Finland. In addition, DNA competes with two much larger players, Telia and Elisa, which have stronger market positions in both mobile and fixed broadband, as well as a larger presence in the corporate segment. DNA is so far mainly focused on smaller businesses and public services, and the markets for larger corporations are still dominated by Elisa and Telia, helped by their more comprehensive product portfolio across telecom, digital, and adjacent services. Moreover, we think that medium- to long-term growth opportunities may be constrained by a high degree of market saturation for mobile subscriptions. As of Dec. 31, 2017, Finland's mobile subscription penetration stood at 173%, the highest in the EU, according to data from the European Commission.

Financial Risk: Modest

Our view of DNA's financial risk profile is supported by its low leverage and strong FOCF generation. Based on our forecast that DNA will distribute most of its solid FOCF to shareholders, we expect that the S&P Global Ratings-adjusted leverage ratio will remain at 1.5x-1.6x over 2018-2019. Our adjustments to debt primarily include the addition of operating lease liabilities of about €190 million (which is the discounted value of operating lease payments relating to certain assets, primarily telecom networks, which we think are essential to run operations over a number of years). We also add about €25 million of spectrum lease liabilities in 2018, an increase of about €16 million compared with those in 2017 following the 5G spectrum auction that concluded in October 2018. In addition, we apply our adjustments for captive finance operations and deconsolidate DNA's equipment installment program from DNA's adjusted credit metrics (see "The Impact Of Captive Finance Operations On Nonfinancial Corporate Issuers," published Dec. 14, 2015, on RatingsDirect). The captive finance adjustments reduce our adjusted debt to EBITDA calculation by about 0.2x.

Liquidity: Adequate

We assess DNA's liquidity as adequate, based on our view that sources will cover uses by more than 1.2x over the coming 12 months. We also take into account the company's satisfactory standing in credit markets, long-standing relationships with banks, and generally prudent risk management.

Principal Liquidity Sources (as of Oct. 1, 2018)	Principal Liquidity Uses (as of Oct. 1, 2018)
• Cash and cash equivalents of about €19 million; • Committed revolving credit facility of €150 million; and • Cash FFO of around €270 million.	• €80 million debt maturities over the coming 12 months; • Annual capex of about €150 million; and • Annual dividend payments of 70%-90% of free cash flow to equity as per the company's financial policy.

Ratings Score Snapshot

Issuer Credit Rating

BBB/Stable/--

Business risk: Satisfactory

- **Country risk:** Low
- **Industry risk:** Intermediate
- **Competitive position:** Satisfactory

Financial risk: Modest

- **Cash flow/Leverage:** Modest

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:** Negative (-1 notch)

Issue Ratings--Subordination Risk Analysis

Capital structure

DNA's capital structure includes about €400 million of financial debt that consists primarily of unsecured bonds. The company also has some smaller bank loans and a commercial paper program, all issued at the parent level.

Analytical conclusions

The rating on DNA's notes is 'BBB' the same level as our long-term issuer credit rating on DNA, reflecting the absence of significant subordination risk, further supported by DNA's low leverage.

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Corporates - General: Methodology: The Impact Of Captive Finance Operations On Nonfinancial Corporate Issuers, Dec. 14, 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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013

- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	**Modest**	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	**bbb+**	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@spglobal.com