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Credit Opinion: Elisa Corporation

Global Credit Research - 20 Apr 2016

Helsinki, Finland

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured -Dom Curr	Baa2

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Key Indicators

[1]**Elisa Corporation**

	12/31/2015	12/31/2014	12/31/2013	12/31/2012	12/31/2011
Scale (USD Billion)	**$1.7**	**$2.0**	**$2.1**	**$2.0**	**$2.1**
EBITDA Margin	**37.4%**	**37.3%**	**35.5%**	**35.8%**	**36.6%**
Debt / EBITDA	**2.0x**	**2.2x**	**2.4x**	**1.9x**	**1.8x**
FCF / Debt	**4.5%**	**1.2%**	**-1.2%**	**-4.6%**	**0.1%**
RCF / Debt	**25.1%**	**21.9%**	**18.8%**	**24.2%**	**24.8%**
(FFO + Interest Expense) / Interest Expense	**17.1x**	**15.4x**	**14.0x**	**14.4x**	**11.0x**
(EBITDA - Capex) / Interest Expense	**10.7x**	**9.9x**	**8.5x**	**9.4x**	**7.3x**

[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

- Strong market position in Finland

- Small size and limited geographical diversification

- Integrated business model

- Operating environment in Finland is relatively stable although economic growth is low

- Predictable financial policies drive stable and conservative credit metrics

Corporate Profile

Elisa is an integrated provider of telecommunications services in Finland with around 4.7 million mobile and 1.0 million fixed line subscriptions as of March 2016. Elisa holds leading positions in Finland in both mobile and fixed line segments with a 39% subscriber market share in mobile and 31% in fixed broadband as of December 2015. The company also operates its own wireless and fixed line network in Estonia, where it is the second largest operator with around 528,100 consumer and 130,500 corporate subscribers as of March 2016 (mobile market share of around 30%).

The Finnish state, through its investment arm Solidium, owns a 10.0 % stake in Elisa. In addition, the State Pension Fund owns a 0.75% stake in the company.

SUMMARY RATING RATIONALE

The Baa2 rating reflects (1) Elisa's integrated business profile and leading positions in Finland's fixed and mobile markets; (2) the broadly stable operating environment in Finland; (3) its solid financial profile; and (4) its track record of operating under predictable financial policies, which include a target leverage of net reported debt/EBITDA in the range of 1.5x-2.0x.

The rating also factors in (1) Elisa's concentration in Finland and lack of material geographical diversification, except for its relatively small exposure to Estonia; (2) its modest domestic growth prospects, which could exert pressure on the company to continue returning cash to shareholders, and (3) the expectation that credit metrics are unlikely to materially improve over the intermediate term in light of the company's financial policies.

DETAILED RATING CONSIDERATIONS

SMALL SIZE AND LIMITED GEOGRAPHICAL DIVERSIFICATION, SOMEWHAT OFFSET BY STRONG MARKET POSITION IN FINLAND

With annual revenues of EUR1.57 billion and EBITDA of EUR532 million in 2015, Elisa is a relatively small incumbent telecom operator in Europe. Its operations are centered in Finland, where it enjoys leading market shares in terms of subscriptions; around 39% in mobile and 31% in fixed broadband as of December 2015, according to the Finnish Communications Regulatory Authority. In Estonia, Elisa operates mainly as a wireless network operator, which contributes around 6.1% of the group's revenues and 5.6% of its EBITDA for the full year ended in December 2015. Elisa's small scale (despite its strong domestic position) and limited geographical diversification (only Estonia) constrain the rating.

INTEGRATED BUSINESS MODEL AND MODERATE TECHNOLOGY RISK

Elisa is an integrated operator in Finland. Overall, we consider an integrated telecom business model such as Elisa's to be more robust than either a standalone fixed-line operation or mobile business. As markets converge, a position in both fixed and mobile should enable an operator to benefit from developing growth trends in either or both segments, as well as hedge its exposure to slowing sub-segments, such as fixed voice. The integrated player has a better platform from which to adopt a range of new products and benefits from the diversity of its business risk.

We view Elisa's technology risk as moderate. Elisa has leading 3G and 4G network coverage positions. The company has made heavy investments in its 4G LTE network, reaching over 97% coverage in Finland and Estonia. Owing to its large spectrum ownership and the low population density in Finland, the company has more spectrum per capita than other European operators. As a result, Elisa is one of the few European players that differentiates its offers by speeds rather than size of data buckets.

OPERATING ENVIRONMENT IN FINLAND IS RELATIVELY STABLE ALTHOUGH ECONOMIC GROWTH IS LOW

Finland (Aaa negative) has high GDP per capita, very high debt affordability, moderate debt-to-GDP ratio, and relatively low unemployment rate (around 9.4%). Nevertheless, the economy is showing sluggish growth, albeit improving from a 0.7% GDP decline in 2014 to a 0.5% growth in 2015 and our expectation of a consecutive 0.5% growth in 2016. This sluggish macroeconomic environment has a bigger impact on the Business division, as corporates are reducing headcount and are pushing for lower prices for their expenditure in telecom services.

In the mobile market, Finland has delivered continued subscriber growth for the past few years. However, we expect the growth potential of mobile data services in Finland to be more limited because the market is very mature. Overall, Finland is the European market with the highest mobile broadband penetration rate (139%)

followed by Sweden (115%) and Denmark (112%).

STABLE MARKET STRUCTURE

Elisa is one of the more stable operators within the European telecoms peer group in terms of operating performance and cash flow generation. This stability derives from a favourable operating environment, where despite slow macroeconomic trends and intense competition, the three established national players (Elisa, Telia Company and DNA) own fixed broadband and mobile assets, and try to take their fair share of modest market growth, with no major shifts in market position. Average prices are relatively low by European market standards, leaving little room for discounted offers by mobile virtual network operators (MVNOs), which only have a 1% share of the market.

The mobile market remains dominated by Elisa, with a 39% market share in terms of subscribers, followed by Telia Company with 34% and DNA with 26%. In fixed broadband, Elisa leads with a 31% market share, followed by Telia Company with 30%, DNA with 25%, and Finnet with 12%.

There was increased competitive intensity in 2013, driven by promotional activity and aggressive handset subsidies. However, in 2014 and 2015, the competitive environment stabilised and Elisa's churn has reduced to 16.2% as of December 2015 from its peak in March 2013 (20.0%).

STRONG OPERATING PERFORMANCE

In Q1 2016, Elisa's revenues grew by 2% and EBITDA by 6%. Mobile service revenue growth remains very strong, one the fastest growth rates in Europe, at 9.1%. This growth is driven by Elisa's successful business model of upselling 3G customers to 4G. Elisa is the only mobile operator that offers unlimited data transfer monthly plans and it has been able to successfully implement an upselling strategy, where it offers faster mobile data speeds in exchange of higher prices. As a result, the average data usage per customer is the highest in Europe, at around 7-8 GB per month.

In addition, the more stable competitive environment has allowed the company to reduce promotional campaigns, as well as to implement price increases. As a result, we expect Elisa's revenues to continue to growth at current rates.

PREDICTABLE FINANCIAL POLICIES DRIVE STABLE AND CONSERVATIVE CREDIT METRICS

Elisa has a track record of maintaining a stable and predictable financial policy that targets a net debt/EBITDA ratio (as reported by the company) of between 1.5x and 2.0x. The company's other key medium-term targets are maintaining an equity ratio above 35% and a maximum capex/sales ratio of 12%.

This stability provides good cash flow visibility and as a result, the company has a generous dividend policy aimed at distributing between 80%-100% of the net result to the extent that net reported debt/EBITDA is maintained within the 1.5x-2.0x target range (broadly equivalent to Moody's adjusted gross debt/EBITDA between 2.0x and 2.5x). Given that the vast majority of excess cash flow is distributed to shareholders, this policy leaves the company with little headroom to accommodate extraordinary capex plans (beyond its 12% capex/sales target) or moderately sized debt-financed M&A.

Elisa's reported net debt/EBITDA stood at 1.8x in 2015, in the middle of the range of its leverage target. The reported retained cash flow (RCF)/debt ratio in 2015 was 25%, also in the middle of the ratio range for the rating category (between 20% and 30%). In light of its generous dividend policy, we expect that Elisa will continue to exhibit credit metrics that are most closely associated with the Baa2 rating.

Liquidity Profile

Elisa's liquidity profile is adequate, supported by cash and cash equivalents of EUR61 million as of March 2016, and full availability under its EUR170 million and EUR130 million committed revolving credit facilities maturing in June 2018 and June 2019, respectively.

These sources, together with expected annual funds from operations (FFO) of around EUR450 million, will more than cover Elisa's cash needs over the next twelve to eighteen months, including EUR146 million commercial paper maturities, approximately EUR200 million in capex and around EUR240 million in dividends.

The next large debt maturity is a EUR131 million bank loan that matures in September 2016, but the company has already pre-financed it with a EUR150 million loan agreed in October 2015.

Rating Outlook

The stable rating outlook assumes that Elisa will perform according to its business plan while maintaining sustainable credit metrics for the current rating category. In addition, it factors in our expectation that the company will maintain an adequate liquidity profile at all times.

What Could Change the Rating - Up

Positive pressure could be exerted on the rating if the company's credit metrics improve such that Moody's adjusted gross debt/EBITDA is well below 2.0x and RCF/adjusted debt is above 30%. Upward rating pressure would also require a track record of solid liquidity management, with the refinancing of debt maturities at least 12 months ahead of repayment.

What Could Change the Rating - Down

Negative rating pressure could result from any potential unexpected deterioration in market conditions, or larger-than-expected investments and further returns to shareholders such that Moody's adjusted gross debt/EBITDA is sustained above 2.5x and RCF/adjusted debt trends towards 20% without any prospect of recovery. Elisa's small scale also exposes the rating to event risk in the form of a leveraged bid for the company, although this risk is mitigated by the company's 10% government ownership.

Other Considerations

RATING METHODOLOGY GRID

The telecoms methodology grid outcome for Elisa, based on our forecasts for the next 12-18 months, is Baa2, in line with the final rating assigned. This outcome is influenced by moderately strong qualitative factors, reflecting Elisa's status as an integrated incumbent in a highly competitive domestic market. These factors are combined with quantitative factors that reflect solid coverage ratios, but also weak cash flow/debt ratios due to the company's high dividend payout policy.

Rating Factors

Elisa Corporation

Global Telecommunications Industry Grid [1][2]	**Current FY 12/31/2015**		[3]**Moody's 12-18 Month Forward ViewAs of 4/18/2016**	
Factor 1: Scale And Business Model, Competitive Environment And Technical Positioning (27%)	**Measure**	**Score**	**Measure**	**Score**
a) Scale (USD Billion)	$1.7	B	$1.7	B
b) Business Model, Competitive Environment and Technical Positioning	Baa	Baa	Baa	Baa
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	Baa	Baa	Baa	Baa
Factor 4:Operating Performance (5%)				
a) EBITDA Margin	37.4%	Baa	34% - 35%	Baa
Factor 5: Financial Strength (47%)				
a) Debt / EBITDA	2.0x	Baa	1.9x - 2.1x	Baa
b) FCF / Debt	4.5%	B	1% - 3%	Caa
c) RCF / Debt	25.1%	Baa	22% - 24%	Ba
d) (FFO + Interest Expense) / Interest Expense	17.1x	Aaa	17.5x - 18.5x	Aaa
e) (EBITDA - Capex) / Interest Expense	10.7x	Aaa	11x - 12x	Aaa
Rating:				
a) Indicated Rating from Grid		Baa1		Baa2

b) Actual Rating Assigned					Baa2

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 12/31/2015; 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.

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