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Elisa Corp.

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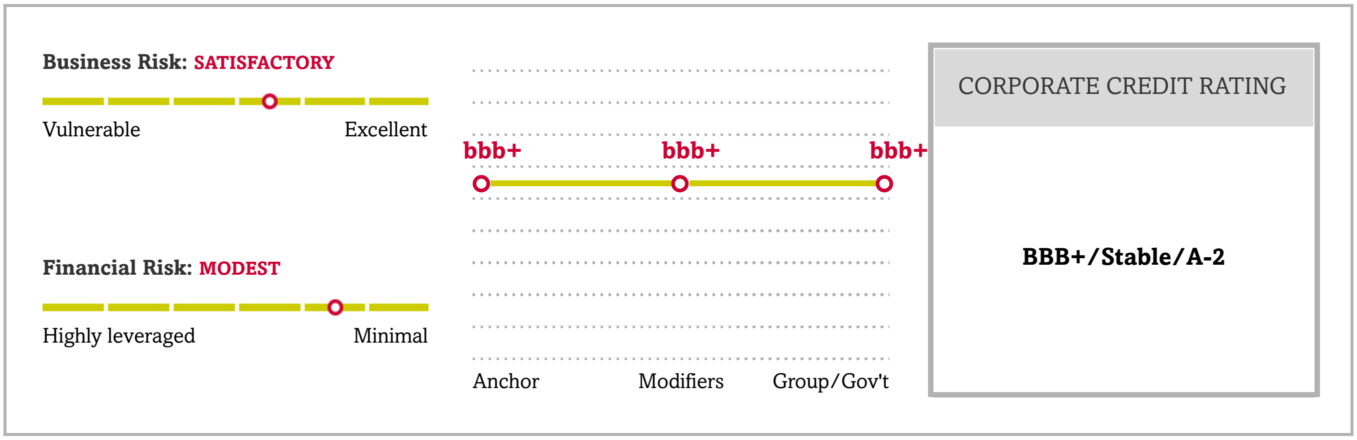

Rationale

Business Risk: Satisfactory	Financial Risk: Modest
• Leading mobile operator and established market position in fixed broadband in Finland. • 4G network with 98% population coverage, supporting the monetization of rising mobile data consumption. • Stable competitive environment in the three-player Finnish mobile market. • More volatile demand for some services in the corporate customer segment. • Few opportunities for subscriber growth and structural decline in landline telephony. • Very limited scale and geographic diversification.	• Modest and manageable capital expenditures (capex). • Modest Standard & Poor's adjusted debt to EBITDA of no higher than 2.0x. • Solid free operating cash flow (FOCF) generation.

Outlook: Stable

The stable outlook reflects our expectation that Elisa Corp. will continue to report stable to modestly growing revenue and EBITDA margins in the next 24 months and that its adjusted debt-to-EBITDA and FOCF-to-debt ratios will remain sustainably below 2x and at about 25%, respectively.

Downside scenario

We could lower the ratings if Elisa's EBITDA or FOCF weakened, for example because competitive pressure caused a pronounced revenue decline or weaker margins. We could also downgrade Elisa if its adjusted debt-to-EBITDA ratio remained above 2x or FOCF to debt declined below 20% for a prolonged period, for instance due to debt-financed acquisitions.

Upside scenario

Rating upside is remote given Elisa's limited scale and diversification and its financial policy, which targets net debt to EBITDA of 1.5x-2.0x.

Standard & Poor's Base-Case Scenario

We expect Elisa to show modest revenue and EBITDA growth in the next two years, paired with limited risk for material increases in capex. Together with our view that Elisa will adhere to its communicated financial policy, we think this will result in stable Standard & Poor's-adjusted leverage of sustainably below 2x and continued favorable FOCF generation.

Assumptions

- Modest revenue growth of 0%-2% in both 2016 and 2017, driven mostly by Elisa's consumer segment.
- Stable to slightly rising EBITDA margins in 2016–2017, enhanced by small-scale, but continuous efficiency measures.
- Capex as a percentage of sales of about 12%-13% including spectrum costs.
- Dividend payments at the higher end of the guidance range of 80%-100% of net profit from 2017.

Key Metrics

	2015A	**2016E**	**2017E**
EBITDA margin* (%)	35.8	35 – 37	35 - 38
Debt to EBITDA* (x)	1.9	1.8 – 2.0	1.8 – 2.0
Funds from operations to debt* (%)	44.5	44 – 46	44 - 46
FOCF to debt* (%)	26.6	25 - 28	25 - 28

*Fully Standard & Poor's-adjusted. FOCF--Free operating cash flow. A--Actual. E--Estimate.

Company Description

Elisa provides fixed and mobile telecommunications services to consumers and corporate customers in Finland and mobile services in Estonia. In addition to connectivity services, the company also offers information and communications technology and online services in adjacent segments, such as information technology (IT) security for enterprise clients or internet protocol television services for consumers. At end-2015, Elisa had about 4.7 million mobile subscribers and about 1 million fixed line subscriptions, including about 530,000 in broadband and 330,000 in cable TV.

Business Risk: Satisfactory

Our assessment of Elisa's business risk is supported by the company's leading share among the three network operators in the Finnish mobile market and its well-established position in fixed-line services in Finland. As of December 2015, Elisa held a 39% market share in mobile subscriptions and was just ahead of TeliaSonera in fixed broadband with a 31% subscriber market share (as of June 2015), according to data published by the Finnish telecoms regulator. Elisa is also the second-largest mobile operator in Estonia with about a 33% subscriber market share at end-2015, according to the company's data.

We also think Elisa benefits from its well-invested 4G network which, as the company estimates, currently covers 98% of the Finnish population. In our view, this puts Elisa in the position to capitalize on surging mobile data usage and rising smartphone penetration. Up-selling to higher speeds and marketing data bundles contributed to Elisa's strong mobile service revenue growth of more than 7% in 2015, with sequentially improving rates jumping to around 11% in the fourth quarter.

Furthermore, we observe that competitive conditions in the Finnish mobile market stabilized in 2015, reducing downside risks to pricing and average revenues per user, in our view. Similarly, while intense competition exists in certain pockets of fixed broadband markets, the overall competitive dynamics are relatively stable, from our perspective. We believe the latter also limits the pressure to invest in expensive network upgrades such as large-scale fiber-to-the-home deployments, reducing the risk of unanticipated capex peaks.

At the same time, our assessment of Elisa's business risk is constrained by the company's very limited scale and geographic diversification. Elisa's customer and revenue base is relatively small compared with European peers, and its footprint is confined to Finland and Estonia. In addition, we consider the business environment in Elisa's corporate segment as somewhat less favorable, as demand for services is susceptible to macroeconomic headwinds and cost cutting efforts of enterprise customers. 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 June 2015, Finland's mobile broadband penetration stood at 139% (subscriptions/population), by far the highest in the EU and well ahead of second-ranking Sweden with 115%, according data gathered by the European Commission.

S&P Base-Case Operating Scenario

- Our revenue forecast is based on a continuation of healthy mobile service revenue growth in 2016–2017 coupled with expansion in new services for consumers and corporates. At the same time, we are expecting to see flattish or modestly decreasing fixed line revenues and no change to the secular decline in landline voice.
- We are projecting a stepwise EBITDA margin expansion in particular from 2017, due to a combination of margin-enhancing mobile service revenue growth, continued cost-cutting, and diminishing margin dilution from new services.
- In our perception, there is only a limited probability in the next two years that Elisa could be forced to step up fixed network investments to the extent that would cause material deviations from its public capex guidance of maximum 12% capex to sales. In the mobile segment, we think that priorities will increasingly shift to capacity as opposed to coverage build-out.

Peer comparison

Table 1

Elisa Corp. -- Peer Comparison

Industry Sector: Incumbent Local Exchange Carrier

	Elisa Corp.	TDC A/S	Telekom Austria AG	TeliaSonera AB
Rating as of March 30, 2016	BBB+/Stable/A-2	BBB-/Stable/A-3	BBB/Stable/A-2	A-/Stable/A-2
(Mil. €)	**--Fiscal year ended Dec. 31, 2015--**			
Revenues	1,569.5	3,265.6	4,026.6	10,658.9
EBITDA	562.3	1,359.4	1,429.9	4,079.2
Funds from operations (FFO)	480.0	1,074.1	1,248.3	3,386.8
Net income from cont. oper.	243.1	(308.4)	392.6	1,529.5
Cash flow from operations	481.5	1,105.2	1,108.3	3,287.1
Capital expenditures	194.5	603.4	715.7	1,701.4
Free operating cash flow	287.0	501.9	392.6	1,585.8
Discretionary cash flow	76.7	287.0	325.5	95.2
Cash and short-term investments	29.1	48.6	911.5	3,030.7
Debt	1,079.4	4,614.0	3,102.7	8,998.6
Equity	925.9	2,355.8	2,420.8	12,273.1
Adjusted ratios				
EBITDA margin (%)	35.8	41.6	35.5	38.2
Return on capital (%)	16.2	7.4	10.9	13.2
EBITDA interest coverage (x)	19.1	7.3	7.9	9.8
FFO cash int. cov. (X)	21.4	6.2	8.8	11.0
Debt/EBITDA (x)	1.9	3.4	2.2	2.2
FFO/debt (%)	44.5	23.3	40.2	37.6
Cash flow from operations/debt (%)	44.6	24.0	35.7	36.5
Free operating cash flow/debt (%)	26.6	10.9	12.7	17.6
Discretionary cash flow/debt (%)	7.1	6.2	10.5	1.0

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Financial Risk: Modest

Key factors in our assessment of Elisa's financial risk are the company's leverage policy and its solid FOCF generation. Management remains committed to keeping net debt to EBITDA, as per the company's definition, between 1.5x and 2.0x, which translates into adjusted debt to EBITDA of below 2.0x in our forecast. We think that Elisa remains determined to participate in the consolidation of the Finnish fixed-line telecom market. Although debt-funded acquisitions could temporarily weaken the company's credit metrics, we expect that it would aim to restore leverage to its targeted band within 12 months. Furthermore, we regard Elisa's capex pattern as relatively stable and predictable, with a low risk of unexpected and significant deviations from its guidance of a capex to sales ratio of maximum 12%. This supports good FOCF generation that compares favorably with other peers in the European telecom sector, in our opinion.

S&P Base-Case Cash Flow And Capital Structure Scenario

- Dividend payments at the higher end of the guidance range of 80%-100% of net profit from 2017 onwards, after about 92% in 2016.
- Recurring spending on small, bolt-on mergers and acquisitions, for example in IT services, or to increase stakes in local fixed-line operators. In 2016, we assume €20 million-€30 million outflows to increase Elisa's stake in Anvia.
- Continued use of commercial paper at €150 million-€250 million a year. Refinancing of other 2016 debt maturities with available €150 million committed bank facilities.
- Adjusted debt-to-EBITDA below 2.0x in absence of material acquisitions and solid reported FOCF of more than €250 million a year.

Financial summary

Table 2

Elisa Corp. -- Financial Summary

Industry Sector: Incumbent Local Exchange Carrier

	--Fiscal year ended Dec. 31--				
	2015	**2014**	**2013**	**2012**	**2011**
Rating history	BBB+/Stable/A-2	BBB/Positive/A-2	BBB/Stable/A-2	BBB/Stable/A-2	BBB/Stable/A-2
(Mil. €)					
Revenues	1,569.5	1,535.2	1,547.4	1,553.4	1,530.0
EBITDA	562.3	550.9	534.4	551.8	544.8
Funds from operations (FFO)	480.0	467.7	443.6	458.6	440.3
Net income from continuing operations	243.1	224.9	196.6	208.7	201.4
Cash flow from operations	481.5	436.7	420.9	382.2	418.9
Capital expenditures	194.5	197.8	212.5	188.9	188.2
Free operating cash flow	287.0	238.9	208.4	193.3	230.7
Discretionary cash flow	76.7	32.2	4.2	(10.2)	27.9

Table 2

Elisa Corp. -- Financial Summary (cont.)					
Industry Sector: Incumbent Local Exchange Carrier					
	--Fiscal year ended Dec. 31--				
	2015	**2014**	**2013**	**2012**	**2011**
Cash and short-term investments	29.1	41.3	137.8	39.8	59.0
Debt	1,079.4	1,069.1	1,044.0	922.9	865.6
Equity	925.9	878.6	862.2	844.9	838.3
Adjusted ratios					
EBITDA margin (%)	35.8	35.9	34.5	35.5	35.6
Return on capital (%)	16.2	16.1	15.6	17.5	17.8
EBITDA interest coverage (x)	19.1	17.1	15.8	16.1	12.3
FFO cash int. cov. (x)	21.4	14.3	13.7	12.4	11.0
Debt/EBITDA (x)	1.9	1.9	2.0	1.7	1.6
FFO/debt (%)	44.5	43.7	42.5	49.7	50.9
Cash flow from operations/debt (%)	44.6	40.8	40.3	41.4	48.4
Free operating cash flow/debt (%)	26.6	22.3	20.0	20.9	26.7
Discretionary cash flow/debt (%)	7.1	3.0	0.4	(1.1)	3.2

Liquidity: Adequate

The short-term rating is 'A-2'. We assess Elisa's liquidity as adequate because we expect sources of liquidity to cover uses by at least 1.2x over the next 12 months. This is despite a significant portion of Elisa's funding consisting of commercial paper with terms shorter than nine months.

We think that Elisa has solid relationships with banks and benefits from a generally satisfactory standing in credit markets.

Principal Liquidity Sources

As of Jan. 1, 2016, Elisa's principal liquidity sources over the ensuing 12 months include:

- Cash balances of €29 million.
- Undrawn revolving credit facilities of €170 million and €130 million maturing in June 2018 and June 2019, respectively.
- Other committed bank lines of €150 million.
- Cash funds from operations of €450 million-€480 million.

Principal Liquidity Uses

As of Jan. 1, 2016, principal liquidity uses over the ensuing 12 months include:

- Debt amortization of about €305 million, including commercial paper maturities of €170 million.
- Capex of about €200 million.
- Dividend payments of €224 million.
- Our estimate of about €20 million-€30 million of outflows to acquire additional shares in local fixed-line operator Anvia.
- Intra-year working capital needs of up to €10 million.

Debt maturities*

- 2016: €131 million
- 2017: €9 million
- 2018: €59 million
- 2019: €300 million
- 2021: €300 million

*Excluding finance leases and commercial paper.

Covenant Analysis

Elisa has to comply with minimum equity ratio covenants under the terms of its revolving credit and several other bank loan facilities. We forecast sufficient headroom of more than 20% under these covenants in the next 24 months.

Ratings Score Snapshot

Corporate Credit Rating

BBB+/Stable/A-2

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:** Neutral (no impact)

Reconciliation

We treat all of Elisa's consolidated cash balances as surplus cash as virtually all of it is accessible without restrictions. We add to debt about €13 million of liabilities for remaining instalments due for 800 megahertz spectrum acquired in 2013.

Table 3

Reconciliation Of Elisa Corp. Reported Amounts With Standard & Poor's Adjusted Amounts

	--Fiscal year ended Dec. 31, 2015--							
(Mil. €)	**Debt**	**Shareholders' equity**	**EBITDA**	**Op. income**	**Interest expense**	**EBITDA**	**Cash flow from operations**	**Capex**
Elisa Corp. reported amounts								
Reported	991.2	925.4	532.5	312.1	24.3	532.5	462.8	199.8
Standard & Poor's adjustments								
Interest expense (reported)	--	--	--	--	--	(24.3)	--	--
Interest income (reported)	--	--	--	--	--	2.8	--	--
Current tax expense (reported)	--	--	--	--	--	(55.7)	--	--
Operating leases	80.4	--	28.6	4.7	4.7	23.9	23.9	--
Postretirement benefit obligations/deferred compensation	11.9	--	0.3	0.3	0.4	(0.12)	0.08	--
Surplus cash	(29.1)	--	--	--	--	--	--	--
Capitalized development costs	--	--	(5.3)	5.3	--	(5.3)	(5.3)	(5.3)
Share-based compensation expense	--	--	6.7	--	--	6.7	--	--
Dividends received from equity investments	--	--	2.4	--	--	2.4	--	--
Non-operating income (expense)	--	--	--	5.1	--	--	--	--
Non-controlling Interest/Minority interest	--	0.5	--	--	--	--	--	--
Debt - Accrued interest not included in reported debt	9.8	--	--	--	--	--	--	--
Debt - Contingent considerations	1.8	--	--	--	--	--	--	--
Debt - Other	13.4	--	--	--	--	--	--	--
EBITDA - Gain/(Loss) on disposals of PP&E	--	--	(2.9)	(2.9)	--	(2.9)	--	--
Total adjustments	88.2	0.5	29.8	12.5	5.1	(52.5)	18.7	(5.3)
Standard & Poor's adjusted amounts								
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Capex**
Adjusted	1,079.4	925.9	562.3	324.6	29.4	480.0	481.5	194.5

Op. income--Operating income. PP&E--Property, plant, and equipment. Capex--capital expenditure.

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Telecommunications And Cable Industry, June 22, 2014
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Related Research

- TeliaSonera AB, March 7, 2016

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-

Ratings Detail (As Of April 8, 2016)

Elisa Corp.	
Corporate Credit Rating	BBB+/Stable/A-2
Senior Unsecured	BBB+
Corporate Credit Ratings History	
18-Mar-2015	BBB+/Stable/A-2
17-Mar-2014	BBB/Positive/A-2
26-Oct-2006	BBB/Stable/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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