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Ratings

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Elisa Corp.

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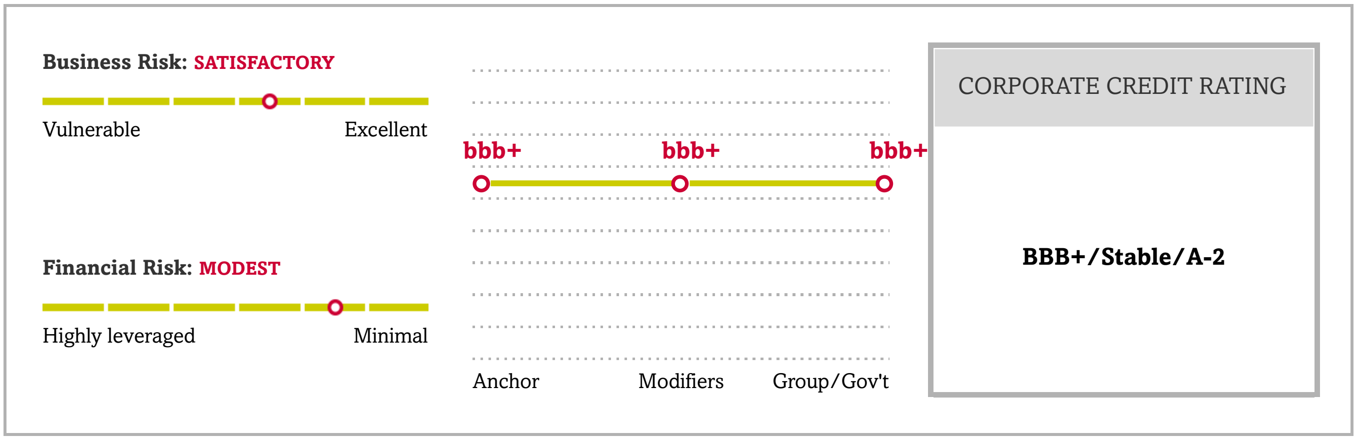

Rationale

Business Risk: Satisfactory

- Leading mobile and fixed broadband operator in Finland, with 40% market share in mobile and 35% in broadband.
- 4G network with 99% population coverage, supporting the monetization of rising mobile data consumption.
- Overall 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.

Financial Risk: Modest

- Conservative financial policy supporting S&P Global Ratings-adjusted debt to EBITDA of no higher than 2.0x.
- Comparatively modest and manageable capital expenditures.
- Good free operating cash flow generation of 25%-30% of adjusted debt in our forecast for 2017-2018.

Outlook: Stable

The stable outlook on Finnish telecommunications service provider Elisa Corp. reflects S&P Global Ratings' expectation that in the next 24 months the company will report organic revenue growth between 0.5% and 2.5%, mainly thanks to higher revenues from mobile and new digital services, and modestly increasing EBITDA margins. We further anticipate that its adjusted debt-to-EBITDA and free operating cash flow (FOCF)-to-debt ratios will be no higher than 2x and between 25% and 30%, respectively.

Downside scenario

We could lower our ratings if Elisa's EBITDA or FOCF weakened, for example because competition 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 decreased to 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, under which it targets net debt to EBITDA of 1.5x-2.0x.

Our Base-Case Scenario

We expect Elisa will deliver modest organic revenue and EBITDA growth in the next two years. Moreover, we think the successful integration of recent acquisitions will bring about additional revenue and cost synergies. Together with our view that Elisa will adhere to its communicated financial policy and our expectation of moderate capex needs, we think this will result in stable S&P Global Ratings-adjusted leverage of below 2x and continued favorable FOCF generation.

Assumptions	Key Metrics

Assumptions

- Organic revenue growth of 0.5%-2.5% in 2017 and 2018, driven particularly by mobile service revenues and new digital services.
- Flat to slightly increasing adjusted EBITDA margins in 2017–2018, enhanced by high-margin mobile service revenue growth, continued small-scale efficiency measures, synergies from acquisitions, and growing scale of new digital services.
- Capital expenditures (capex) as a percentage of sales of about 13% in 2017, temporarily higher due to integration capex for Anvia, and receding to 12%-13% in 2018 including spectrum costs.
- Dividend payments at the higher end of the guidance range of 80%-100% of the previous year's net profit, as of 2018, after about 93% in 2017.

Key Metrics

	2016a	2017f	2018f
EBITDA margin* (%)	36.7	36-37.5	36-38
Debt/EBITDA* (x)	2.1	1.8–2.0	1.7–1.9
FFO/debt* (%)	41	45-47	47-50
FOCF/debt* (%)	24	25-27	28-31

*Fully S&P Global Ratings adjusted. FFO--Funds from operations. FOCF--Free operating cash flow. a--Actual. f--Forecast.

Company Description

Elisa provides fixed and mobile telecommunications services to consumers and corporate customers in Finland. Following the acquisition of Starman, Elisa also offers broadband and TV services in Estonia, in addition to its mobile operations in this market. Along with connectivity services, the company also offers information and communications technology and digital services in adjacent segments, such as information technology (IT) security for enterprise clients or internet protocol television services for consumers. At the end of the first quarter of 2017, Elisa had about 4.7 million mobile subscribers and approximately 1.2 million fixed line subscriptions, including about 594,000 in broadband and 447,000 in cable TV. In 2016, Elisa generated about 63% of revenues and 66% of EBITDA from the provision of services to consumers, and the remainder from its corporate customer business.

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, as well as its leading position in fixed broadband services in Finland. As of December 2016, Elisa held a 40% market share in mobile subscriptions, marginally down from 41% one year earlier, based on company data. The acquisition of Anvia in July 2016 helped Elisa to grow its subscriber market share in fixed broadband to about 35% at year-end 2016, compared with about 31% at the end of 2015, according to data by the Finnish telecoms regulator. Elisa is also the second-largest mobile operator in Estonia with a subscriber market share of about 32% at end-2016, and, following the acquisition of cable operator Starman, holds about a 35% market share in pay-TV services and 23% in the fixed broadband market, according to the company's data.

We think Elisa benefits from its well-invested 4G network which, per the company's estimates, currently covers 99% of the Finnish population. In our view, this puts Elisa in the position to capitalize on rising mobile data usage and smartphone penetration. Up-selling to higher speeds contributed to Elisa's strong mobile service revenue growth of about 6% in 2016 and 5.5% in the first quarter of 2017. Although we expect competition in the Finnish mobile market to remain intense, we think the risks of a material and sustained deterioration of pricing and average revenues per user remain limited. Similarly, although intense competition exists in certain pockets of fixed broadband markets, overall competitive dynamics are relatively stable, from our perspective. Elisa is upgrading its fixed broadband network on an opportunistic basis, but we believe there is only modest pressure to invest in very expensive network upgrades such as large-scale fiber-to-the-home deployments at this stage, reducing the risk of unanticipated capex peaks. The ability to offer a complete portfolio of mobile, fixed-line and TV services after the combination with Starman incrementally strengthens Elisa's market position in Estonia, in our opinion.

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 remains more 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 2016, Finland's mobile broadband penetration stood at 147% (subscriptions/population), the highest in the EU and well ahead of second-ranking Denmark with 123%, according to data from the European Commission.

Our Base-Case Operating Scenario

- We base our revenue forecast for Elisa on continued healthy mobile service revenue growth in 2017–2018, coupled with expansion in new digital services for consumers and corporates. At the same time, we are expecting to see flattish or modestly decreasing fixed broadband revenues and no change to the secular decline in landline voice services.
- We are projecting gradual EBITDA margin expansion, in particular from 2018, due to a combination of margin-enhancing mobile service revenue growth, continued cost-cutting, diminishing margin dilution from new services, and synergies from acquisitions.
- We think that Elisa will continue to upgrade its fixed broadband network to higher speeds and invest in coverage and capacity improvements in mobile, but we consider the risk that Elisa could be forced to significantly step-up network investments, particularly in its fixed network, as moderate.

Peer comparison

Table 1

Elisa Corp. -- Peer Comparison

Industry Sector: Diversified Telecom

(Mil. €)	Elisa Corp.	Telia Company AB	TDC A/S	Telekom Austria AG
Rating as of April 24, 2017	BBB+/Stable/A-2	A-/Negative/A-2	BBB-/Stable/A-3	BBB/Stable/A-2
Fiscal year ended	Dec. 31, 2016	Dec. 31, 2016	Dec. 31, 2016	Dec. 31, 2015
Revenues	1,635.7	8,780.9	2,827.5	4,026.6

Table 1

Elisa Corp. -- Peer Comparison (cont.)				
Industry Sector: Diversified Telecom				
(Mil. €)	**Elisa Corp.**	**Telia Company AB**	**TDC A/S**	**Telekom Austria AG**
EBITDA	599.5	3,133.6	1,220.2	1,300.7
Funds from operations (FFO)	514.0	2,636.0	1,001.1	1,058.4
Net income from cont. oper.	257.1	1,425.9	264.6	392.6
Cash flow from operations	507.5	2,892.8	969.7	1,057.5
Capital expenditures	206.1	1,941.5	598.8	715.7
Free operating cash flow	301.4	951.4	370.9	341.8
Discretionary cash flow	78.2	(651.5)	357.7	291.5
Cash and short-term investments	44.5	1,513.6	226.8	911.5
Debt	1,250.5	8,174.0	4,069.3	3,570.2
Equity	971.3	9,896.1	2,881.2	2,126.0
Adjusted ratios				
EBITDA margin (%)	36.7	35.6	43.2	32.3
Return on capital (%)	16.4	9.4	6.4	8.5
EBITDA interest coverage (x)	21.3	9.8	7.6	6.3
FFO cash interest coverage (x)	24.6	11.1	5.5	6.8
Debt/EBITDA (x)	2.1	2.6	3.3	2.7
FFO/debt (%)	41.1	32.2	24.6	29.6
Cash flow from operations/debt (%)	40.6	35.3	23.8	29.6
Free operating cash flow/debt (%)	24.1	11.6	9.1	9.6
Discretionary cash flow/debt (%)	6.3	(8.0)	8.8	8.2

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 no more than 2.0x in our forecast. We think that Elisa may continue to pursue smaller acquisitions, for example, to participate in the consolidation of the Finnish fixed-line telecom market or in the IT and digital services sector. 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 fairly stable and predictable, with a low risk of unexpected and significant deviations from its guidance of a capex-to-sales ratio of 13% in 2017 and no more than 12% in the medium term. This supports good FOCF generation that compares favorably with other peers in the European telecom sector, in our opinion.

Our Base-Case Cash Flow And Capital Structure Scenario

- Dividend payments at the higher end of the company's guidance range of 80%-100% of the previous year's net profit, from 2018 onward, after about 93% in 2017.
- Some spending on small mergers and acquisitions, for example in IT services, or for local fixed-line operators.
- Adjusted debt to EBITDA below 2.0x, in the absence of material acquisitions, and reported FOCF of more than €260 million a year.
- Continued use of commercial paper of up to €250 million a year.

Financial summary

Table 2

Elisa Corp. -- Financial Summary

Industry Sector: Diversified Telecom

	--Fiscal year ended Dec. 31--				
(Mil. €)	**2016**	**2015**	**2014**	**2013**	**2012**
Revenues	1,635.7	1,569.5	1,535.2	1,547.4	1,553.4
EBITDA	599.5	562.3	550.9	534.4	551.8
Funds from operations (FFO)	514.0	480.0	467.7	443.6	458.6
Net income from continuing operations	257.1	243.1	224.9	196.6	208.7
Cash flow from operations	507.5	481.5	436.7	420.9	382.2
Capital expenditures	206.1	194.5	197.8	212.5	188.9
Free operating cash flow	301.4	287.0	238.9	208.4	193.3
Discretionary cash flow	78.2	76.7	32.2	4.2	(10.2)
Cash and short-term investments	44.5	29.1	41.3	137.8	39.8
Debt	1,250.5	1,079.4	1,069.1	1,044.0	922.9
Equity	971.3	925.9	878.6	862.2	844.9
Adjusted ratios					
EBITDA margin (%)	36.7	35.8	35.9	34.5	35.5
Return on capital (%)	16.4	16.2	16.1	15.6	17.5
EBITDA interest coverage (x)	21.3	19.1	17.1	15.8	16.1
FFO cash interest coverage (x)	24.6	21.4	14.3	13.7	12.4
Debt/EBITDA (x)	2.1	1.9	1.9	2.0	1.7
FFO/debt (%)	41.1	44.5	43.7	42.5	49.7
Cash flow from operations/debt (%)	40.6	44.6	40.8	40.3	41.4
Free operating cash flow/debt (%)	24.1	26.6	22.3	20.0	20.9
Discretionary cash flow/debt (%)	6.3	7.1	3.0	0.4	(1.1)

Liquidity: Adequate

The short-term rating is 'A-2'. We assess Elisa's liquidity as adequate because we expect its sources of liquidity will cover uses by more than 1.2x over the 12 months started April 1, 2017. We note that a significant portion of Elisa's funding frequently consists of commercial paper with terms shorter than 12 months.

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

Principal Liquidity Sources	Principal Liquidity Uses
As of April 1, 2017, Elisa's principal liquidity sources over the ensuing 12 months include: • Cash balances of about €216 million. • An undrawn revolving credit facility (RCF) of €130 million maturing in June 2021, and €90 availability under the company's €170 million RCF due June 2018. • Funds from operations of €510 million-€540 million. • €44 inflows from the sale of Comptel shares.	For the same period, principal liquidity uses include: • Debt amortization of about €205 million, including commercial paper maturities of €193 million. • Capex of €220 million-€240 million. • Dividend payments of about €240 million. • €28 million of outflows for the acquisition of Santa Monica Networks. • Intrayear working capital needs of up to €10 million.

Debt maturities*

As of April 1, 2017:

- 2017: €5 million
- 2018: €59 million
- 2019: €180 million
- 2021: €300 million
- 2023: €150 million
- 2024: €300 million

*Excluding finance leases and RCFs.

Covenant Analysis

Elisa must comply with minimum equity ratio covenants under the terms of its revolving credit and 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 €29 million of liabilities for remaining instalments due for 800 megahertz spectrum acquired in 2013 and 700 megahertz spectrum acquired in 2016.

Table 3

Reconciliation Of Elisa Corp. Reported Amounts With S&P Global Ratings Adjusted Amounts (Mil. €)

	--Fiscal year ended Dec. 31, 2016--							
Elisa Corp. reported amounts								
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**	**Capital expenditures**
Reported	1,168.5	970.8	563.1	339.3	22.4	563.1	486.5	208.9
S&P Global Ratings' adjustments								
Interest expense (reported)	--	--	--	--	--	(22.4)	--	--
Interest income (reported)	--	--	--	--	--	2.7	--	--
Current tax expense (reported)	--	--	--	--	--	(60.1)	--	--
Operating leases	73.9	--	29.3	5.4	5.4	23.9	23.9	--
Postretirement benefit obligations/deferred compensation	12.9	--	0.3	0.3	0.3	0.0	(0.1)	--
Surplus cash	(44.5)	--	--	--	--	--	--	--
Capitalized development costs	--	--	(2.8)	5.7	--	(2.8)	(2.8)	(2.8)
Share-based compensation expense	--	--	8.3	--	--	8.3	--	--

Table 3

Reconciliation Of Elisa Corp. Reported Amounts With S&P Global Ratings Adjusted Amounts (Mil. €) (cont.)								
Dividends received from equity investments	--	--	3.1	--	--	3.1	--	--
Non-operating income (expense)	--	--	--	1.3	--	--	--	--
Non-controlling interest/Minority interest	--	0.5	--	--	--	--	--	--
Debt - Accrued interest not included in reported debt	9.8	--	--	--	--	--	--	--
Debt - Contingent considerations	1.2	--	--	--	--	--	--	--
Debt - Spectrum	28.7	--	--	--	--	--	--	--
EBITDA - Gain/(Loss) on disposals of PP&E	--	--	(0.7)	(0.7)	--	(0.7)	--	--
EBITDA - Business divestments	--	--	(1.1)	(1.1)	--	(1.1)	--	--
Total adjustments	82.0	0.5	36.4	10.9	5.7	(49.1)	21.0	(2.8)
S& P Global Ratings' adjusted amounts								
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Capital expenditures**
Adjusted	1,250.5	971.3	599.5	350.2	28.1	514.0	507.5	206.1

PP&E--Plant, property, and equipment.

Related Criteria And Research

- 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
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Rating Each Issue, April 15, 2008

Business And Financial Risk Matrix

Business Risk Profile	Financial 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 24, 2017)

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. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' 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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