S&P Global
Ratings

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Elisa Oyj

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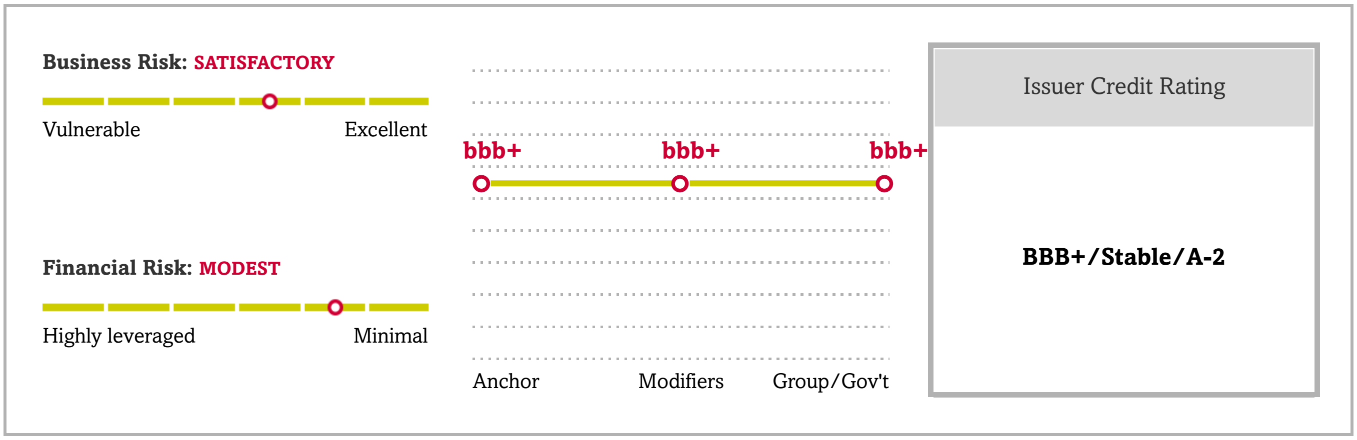


Credit Highlights

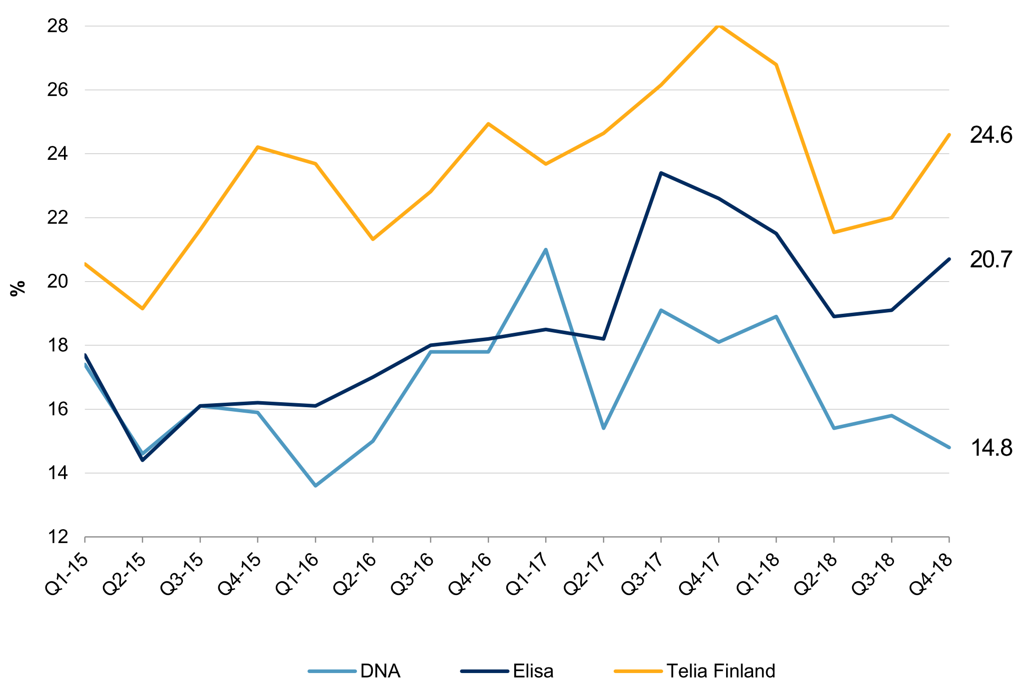
Overview

Key Strengths	Key Risks
Leading telecommunications operator in Finland, with a 37% market share in mobile and 35% in fixed broadband.	Limited scale compared with many European peers, with annual EBITDA of about €670 million and a comparatively narrow geographic focus.
A well-invested mobile 4G network, supporting the monetization of rising mobile data consumption.	Intense competition in certain parts of the residential broadband and business-to-business (B2B) segments.
Overall stable competitive environment in the three-player Finnish telecom market.	Commercial paper maturing in less than 12 months typically constituting 10%-25% of total debt.
Conservative financial policy targeting net debt to EBITDA of 1.5x–2.0x, translating into S&P Global Ratings-adjusted debt to EBITDA of less than 2.0x.	Modestly invested fixed networks, which could lead to higher capital expenditure (capex) if competitors offer higher fixed broadband speeds.
Relatively low capex of 12%-13% of sales, leading to strong free operating cash flow (FOCF) of 28%-30% of debt.	

Elisa remains the No. 1 player in the Finnish mobile market, despite heightened competition. The market experienced intense competition during second-half 2018, leading to a higher customer churn (see chart 1) and flat average revenue per user (ARPU; see chart 2). However, Elisa holds a leading 37% mobile subscriber market share, ahead of Telia (34%), and DNA (28%). Although we expect less aggressive tactics and a more stable market, we forecast that mobile service revenue growth will slow to about 2% in 2019-2020 from a high of 5%-8% in 2015-2017, following 2.5% growth in 2018. The Finnish mobile market has good quality networks and high saturation for mobile subscriptions. The three operators hold equal or very similar amounts of spectrum in all key bands, and both Elisa and DNA report 4G coverage spanning more than 99% of the population. However, Elisa has the widest spectrum availability among all three peers. At end-2018, Finland's subscription penetration (subscriptions/population) was the highest in the EU at above 150%. We believe these conditions create few incentives for a prolonged period of intense price competition.

Chart 1

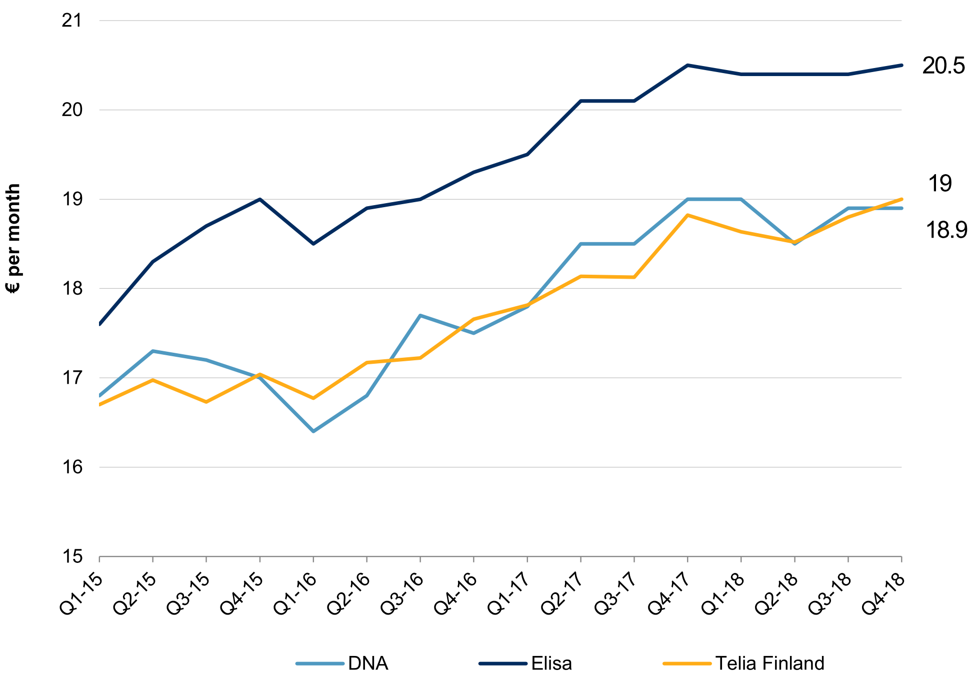
Finnish Mobile Market--Yearly Customer Attrition



Source: Company reports. Numbers are not fully comparable between operators due to disclosure differences.

Chart 2

Finnish Mobile Market--Postpaid Average Revenue Per User



Source: Company reports. Numbers are not fully comparable between operators due to disclosure differences.

The launch of 5G in 2019 could support ARPU expansion. Finland allocated 5G spectrum in the 3.4 gigahertz (GHz)-3.8GHz band in October 2018 for about €0.036 per megahertz per capita, among the lowest European prices to date. Furthermore, we think the Finnish telecom market exhibits sound characteristics to commercialize 5G offerings, because it has both the highest data consumption per subscriber in the world (16GB per month on average in 2018) and relatively low penetration of fiber. Less than 30% of the population has a download speed above 100 megabits per second, creating an opportunity for ultrafast mobile broadband services. In our view, the first commercial cases for 5G in Finland include upselling mobile broadband with a higher speed and better quality than 4G, and fixed wireless access in rural areas. We expect initial commercialization in late 2019 or 2020, with the first 5G-compatible handsets becoming available in second-half 2019. However, we do not expect any significant change in revenue or capex, given that the company has maintained its guidance despite a gradual 5G rollout, and our cautious view of 5G revenue prospects in the near term.

Elisa has a well-defined and conservative financial policy. The company has a publicly defined net leverage (net debt to EBITDA) target of 1.5x-2.0x, which we expect it will continue to follow. Furthermore, management has indicated that if the company exceeds this, maybe due to an acquisition, it will not tolerate net leverage above 2.2x and will focus on reducing leverage to the target. Elisa's public net leverage target translates into adjusted leverage below 2.0x.

Outlook: Stable

The stable outlook on Elisa reflects our expectation that the company will report stable adjusted EBITDA margins of 35%-37% and pro forma revenue growth of 0.5%-2.5% in the next 12 months, mainly thanks to higher revenue from mobile and new digital services. We further anticipate that adjusted debt to EBITDA will be below 2.0x and FOCF to debt at 28%-33%.

Downside scenario

We could lower our ratings if Elisa's EBITDA or FOCF weakened, for example if intense competition caused a pronounced revenue decline or weaker margins, or if unexpected competitive developments forced Elisa to significantly step up its capex. We could also downgrade Elisa if its adjusted debt to EBITDA increased to 2.0x or higher, or adjusted FOCF to debt decreased toward 20% for a prolonged period, for instance due to debt-financed acquisitions or high shareholder returns.

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

Assumptions

- Real GDP growth in Finland of 1.8% in 2019 and 1.5% in 2020, after 2.2% in 2018, supporting demand for digital and information technology services in the B2B market.
- Finland's unemployment rate decreasing to 73% in 2019 and 7.1% in 2020, compared with 7.4% in 2018, facilitating the upselling of better mobile plans and additional services such as internet protocol television (IPTV) in the business-to-consumer (B2C) segment.
- Revenue growth of 1.5%-2.5% in 2019 and 2020, due in particular to increasing mobile service revenue and new digital services, but balanced by flat fixed broadband revenue and a continued decline in landline voice and B2B fixed connectivity revenue.
- A stable adjusted EBITDA margin of 36%-37% in 2019, following 36.6% in 2018. This could potentially improve to 37% in 2020 and beyond enhanced by high-margin mobile service revenue growth and the increasing scale of new digital services.
- Capex to sales of 12%-13% in 2019-2020, up from 12.9% in 2018.
- A dividend payout ratio of about 90% in 2019-2020, after about 89% in 2018, given Elisa's stated financial policy of distributing 80%-100% of net profit.

Key Metrics

	2018A	2019E	2020E
Debt to EBITDA (x)	1.5	1.5-1.6	1.5-1.6
FFO to debt (%)	56.7	55.0-56.0	56.0-57.0
FOCF to debt (%)	26.0	27.0-28.0	28.0-29.0

S&P Global Ratings-adjusted metrics, after captive finance adjustments where applicable. A--Actual. E--Estimate. FFO--Funds from operations. FOCF--Free operating cash flow.

Base-case projections

We expect revenue growth to stem from continued upselling of mobile subscriptions. The number of fixed broadband and mobile subscriptions (excluding machine-to-machine SIM cards) is expected to remain fairly flat over the next two years. However, we think that upselling higher-speed packages to customers will produce modest growth in mobile service revenue. In addition, we expect revenue growth from demand for the internet of things (IoT) and other digital services in the B2B segment, but this could come under competitive pressure because DNA's new owner, Telenor, is likely to target this segment. Revenue growth could also be balanced by a secular decline in traditional fixed network subscriptions and flat fixed broadband revenue, with the upselling of higher speeds to be constrained by intense competition in multi-dwelling units.

Elisa's manageable capex levels should lead to continued strong FOCF. We expect capex will sales to remain at 12%-13%, stemming from continued investments in the fixed broadband network, improvements in coverage and capacity in the mobile network, and the start of the 5G rollout--albeit at a small scale. This will lead to continued strong FOCF exceeding 25% of adjusted debt. However, we see a risk that increasing competition or shifting demand may lead to higher capex in the medium-to-long term if Elisa needs to ramp up deployment of fiber to the home or business (FTTH or FTTB). In our view, the risk is currently moderate, given current competitive conditions and demand patterns. In addition, Elisa is gradually upgrading its networks to higher speeds, and is able to serve 75% of its coverage area with fiber-to-the-curb or FTTH/FTTB connections.

Company Description

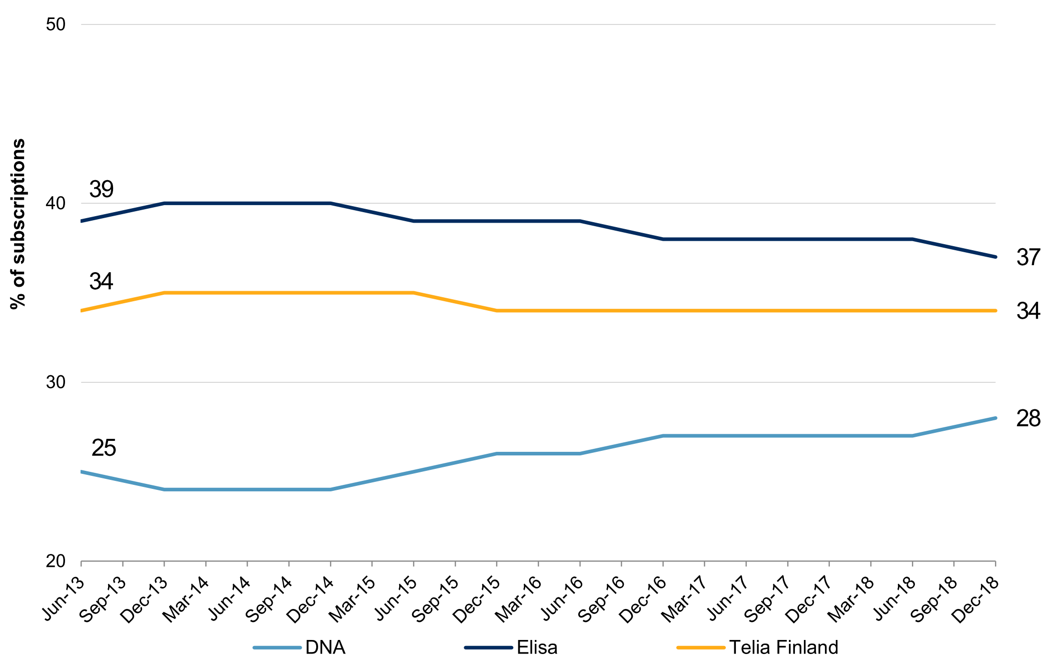
Elisa provides fixed and mobile telecom services to consumers and corporate customers in Finland. With the acquisition of cable operator Starman in 2017, the company has also become a converged operator in Estonia, complementing its mobile services in this market with fixed broadband and TV. Along with connectivity services, the company offers information and communications technology and digital services in adjacent segments, such as IT security for enterprise clients or IPTV for consumers. At end-2018, Elisa had about 4.66 million mobile subscribers (of which 90% are postpaid) and approximately 1.5 million fixed-line subscriptions, including 696,000 in broadband and 612,000 in cable-TV. In 2018, Elisa generated about 63% of its €1.83 billion revenue and 65% of its €640 million EBITDA from the provision of services to consumers, and the remainder from its corporate customer business.

Business Risk: Satisfactory

Elisa has leading positions in the Finnish mobile and broadband markets, which have relatively stable structures but intermittently intense competition. Despite its small geographic footprint, Elisa is No. 1 in the three-player Finnish mobile market with a 37% market share (see chart 3) and 35% in the more fragmented fixed broadband market (see chart 4). Although intense competition exists in certain pockets of the fixed broadband market, such as for multi-dwelling units, overall competitive dynamics remain relatively stable, from our perspective. This is partly because the three main players' broadband networks are regionally concentrated and have limited overlap, and incentives for operators to poach customers from outside their footprint have so far been limited. We expect No. 3 player DNA will continue to make modest market share gains, helped by its high-speed cable network. That said, we note that Elisa has managed to defend its fixed broadband market share of 35% since end-2016, while Telia took most of the market share losses during this period.

Chart 3

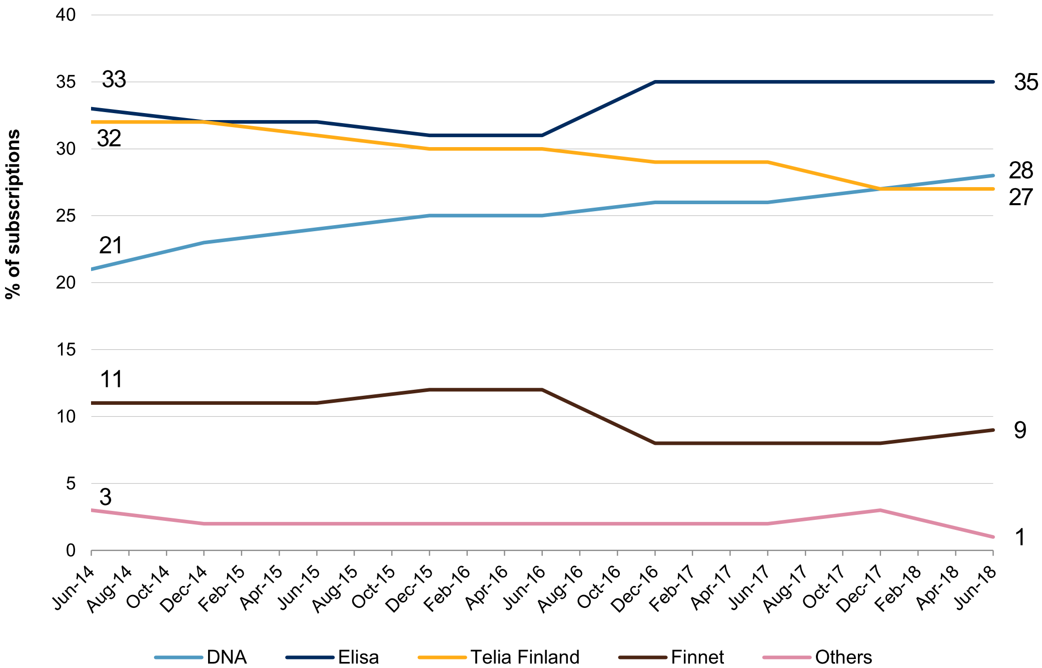
Finnish Mobile Market--Subscriber Market Share



Source: Traficom.

Chart 4

Finnish Fixed-Line Market--Subscriber Market Share



Source: Traficom.

In addition to telecom, Elisa provides several other digital services, such as IPTV, cloud—based IT, videoconferencing, and IoT. Elisa is looking to expand its portfolio of adjacent products, since these are an important contributor to growth. This added diversification is positive, but it does not offset our assessment that Elisa's total revenue base is significantly smaller than that of many European telecom peers and that its footprint is confined to Finland (91% of EBITDA in 2018) and Estonia (9%).

Peer comparison

We view Elisa's overall credit quality as one notch stronger than its main competitor DNA, primarily due to its stronger market position in Finland--in particular in B2B--and its greater revenue contribution from adjacent services. Our rating on Elisa is on par with that on Telia, reflecting Telia's much larger scale but Elisa's stronger credit metrics.

Table 1

Elisa Oyj--Peer Comparison

Industry Sector: Diversified Telecom

	Elisa Oyj	DNA PLC	Telia Company AB	Tele 2
Rating as of May 21, 2019	BBB+/Stable/A-2	BBB/Watch Pos/--	BBB+/Stable/A-2	BBB/Stable/A-2

Table 1

Elisa Oyj--Peer Comparison (cont.)				
(Mil. €)	**--Fiscal year ended Dec. 31, 2018--**			
Revenue	1,831.5	911.8	8,212.4	2,329.7
EBITDA	670.2	335.7	2,789.1	733.6
Funds from operations (FFO)	576.1	303.6	2,321.8	600.3
Interest expense	30.2	25.0	291.2	56.4
Cash interest paid	25.8	19.7	345.2	70.1
Cash flow from operations	529.1	243.3	2,712.7	616.2
Capital expenditure	227.4	145.1	1,440.6	336.5
Free operating cash flow	301.7	98.2	1,272.0	279.7
Discretionary cash flow	38.6	(47.1)	(123.3)	81.8
Cash and short-term investments	80.9	22.7	1,844.2	39.8
Debt	1,159.7	526.0	6,591.7	3,205.5
Equity	1,126.9	586.0	10,836.3	3,573.8
Adjusted ratios				
EBITDA margin (%)	36.6	36.8	34.0	31.5
Return on capital (%)	17.6	14.2	7.9	7.6
EBITDA interest coverage (x)	22.2	13.4	9.6	13.0
FFO cash interest coverage (x)	23.3	16.4	7.7	9.6
Debt/EBITDA (x)	1.7	1.6	2.4	4.4
FFO/debt (%)	49.7	57.7	35.2	18.7
Cash flow from operations/debt (%)	45.6	46.2	41.2	19.2
Free operating cash flow/debt (%)	26.0	18.7	19.3	8.7
Discretionary cash flow/debt (%)	3.3	(9.0)	(1.9)	2.6

Elisa's and DNA's financials and adjusted ratios are before our captive finance adjustments.

Financial Risk: Modest

Elisa displays a conservative leverage policy and solid FOCF generation, in our view. Furthermore, we regard Elisa's capex pattern as fairly stable and predictable at this stage, with a moderate risk of unexpected and significant medium-term deviations from its targeted capex to sales ratio of 12%-13%, which the company has adhered to for many years and forecasts for 2019-2020. This supports good FOCF generation that compares favorably with other peers in the European telecom sector, in our opinion.

Financial summary

Table 2

Elisa Oyj--Financial Summary					
Industry Sector: Diversified Telecom					
	--Fiscal year ended Dec. 31--				
(Mil. €)	**2018**	**2017**	**2016**	**2015**	**2014**
Revenue	1,831.5	1,787.4	1,635.7	1,569.5	1,535.2
EBITDA	670.2	641.5	599.5	562.3	550.9

Table 2

Elisa Oyj--Financial Summary (cont.)					
Industry Sector: Diversified Telecom					
	--Fiscal year ended Dec. 31--				
(Mil. €)	**2018**	**2017**	**2016**	**2015**	**2014**
Funds from operations (FFO)	576.1	551.7	507.0	481.8	461.8
Interest expense	30.2	29.1	28.1	29.4	32.2
Cash interest paid	25.8	26.2	27.4	28.5	38.9
Cash flow from operations	529.1	515.0	507.6	481.4	436.5
Capital expenditure	227.4	246.6	206.1	194.5	197.8
Free operating cash flow	301.7	268.4	301.5	286.9	238.7
Discretionary cash flow	38.6	28.8	78.3	76.6	32.0
Cash and short-term investments	80.9	44.3	44.5	29.1	41.3
Gross available cash	80.9	44.3	44.5	29.1	41.3
Debt	1,159.7	1,226.1	1,240.7	1,069.6	1,069.1
Equity	1,126.9	1,039.8	971.3	925.9	878.6
Adjusted ratios					
EBITDA margin (%)	36.6	35.9	36.7	35.8	35.9
Return on capital (%)	17.6	17.1	16.6	16.5	16.2
EBITDA interest coverage (x)	22.2	22.1	21.3	19.1	17.1
FFO cash interest coverage (x)	23.3	22.1	19.5	17.9	12.9
Debt/EBITDA (x)	1.7	1.9	2.1	1.9	1.9
FFO/debt (%)	49.7	45.0	40.9	45.0	43.2
Cash flow from operations/debt (%)	45.6	42.0	40.9	45.0	40.8
Free operating cash flow/debt (%)	26.0	21.9	24.3	26.8	22.3
Discretionary cash flow/debt (%)	3.3	2.3	6.3	7.2	3.0

Elisa's financials and adjusted ratios in our financial summary table below are before our captive finance adjustments. See the reconciliation section at the end of this report for estimates of adjusted debt to EBITDA and FOCF to debt after captive finance adjustments.

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 from Jan. 1, 2019. 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
Elisa's principal liquidity sources over the 12 months from Jan. 1, 2019, include: • Cash balances of about €81 million. • €300 million available under two undrawn revolving credit facilities (RCFs), with €130 million due in 2021, and €170 million due in 2022. • Funds from operations (FFO) of about €550 million.	For the same period, principal liquidity uses include: • Debt maturities of about €280 million, including a €100 million prepayment of the euro medium-term note due in 2021. • Capex of €230 million-€250 million. • Dividend payments of about €283 million. • Working capital-related outflows of €10 million-€15 million and intrayear working capital needs of up to €25 million.

Debt maturities

As of Dec. 31, 2018:

- 2019: €180 million
- 2021: €300 million
- 2023: €150 million
- 2024: €300 million

Figures exclude finance leases, commercial paper, and RCFs.

Covenant Analysis

Elisa must comply with minimum equity ratio covenants under the terms of its RCFs and bank loans. We forecast comfortable headroom of more than 30% under these covenants in the next 24 months.

Issue Ratings - Subordination Risk Analysis

With the exception of finance leases, Elisa's capital structure consists entirely of senior unsecured debt, of which €939 million is bonds and €250 million was issued by the parent company. At the end of first-quarter 2019, the €1.29 billion of outstanding debt comprised €939 million of bonds, €250 million of loans from financial institutions, €90 million of financial leases, and €10 million of commercial paper. We assess the subordination risk for group-level creditors as limited and rate Elisa's senior unsecured debt at the same level as the issuer credit rating.

Reconciliation

Table 3

Reconciliation Of Elisa Oyj Reported Amounts With S&P Global Ratings' Adjusted Amounts (mil. €)

	--Fiscal year ended Dec. 31, 2018--							
Elisa Oyj reported amounts								
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**	**Capital expenditure**
	1,148.7	1,126.4	640.0	403.8	23.3	670.2	515.4	235.6
S&P Global Ratings' adjustments								
Cash taxes paid	--	--	--	--	--	(68.2)	--	--
Cash taxes paid - Other	--	--	--	--	--	--	--	--
Cash interest paid	--	--	--	--	--	(19.2)	--	--
Operating leases	66.9	--	28.6	6.6	6.6	(6.6)	21.9	--
Postretirement benefit obligations/deferred compensation	11.8	--	0.2	0.2	0.3	--	--	--
Accessible cash & liquid investments	(80.9)	--	--	--	--	--	--	--
Capitalized development costs	--	--	(8.2)	(5.6)	--	--	(8.2)	(8.2)
Share-based compensation expense	--	--	15.9	--	--	--	--	--
Dividends received from equity investments	--	--	0.2	--	--	--	--	--
Nonoperating income (expense)	--	--	--	1.7	--	--	--	--
Noncontrolling interest/minority interest	--	0.5	--	--	--	--	--	--
Debt - Other	13.2	--	--	--	--	--	--	--
EBITDA - Gain/(loss) on disposals of PP&E	--	--	(1.1)	(1.1)	--	--	--	--
EBITDA - Business divestments	--	--	(5.4)	(5.4)	--	--	--	--
D&A - Impairment charges/(reversals)	--	--	--	0.4	--	--	--	--
Total adjustments	11.0	0.5	30.2	(3.2)	6.9	(94.0)	13.7	(8.2)
S&P Global Ratings' adjusted amounts								
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Capital expenditure**
	1,159.7	1,126.9	670.2	400.6	30.2	576.1	529.1	227.4

We apply our standard adjustment for operating leases to Elisa's financials. However, starting with the 2018 annual results, we adjust the reported operating lease schedule taken from the company's audited accounts. We extend minimum lease payments for certain types of assets (including network assets) for a certain number of years so as to make the schedule more reflective of the period of economic use of the asset.

Elisa offers customers so-called equipment instalment plans to finance the cost of their mobile handsets and certain other devices. These plans qualify as captive finance operations under our criteria (see "Standard & Poor's Analytical Approach To Wireless Equipment Installment Plans," published March 30, 2016, on RatingsDirect). In line with our criteria, "The Impact Of Captive Finance Operations On Nonfinancial Corporate Issuers," published Dec. 14, 2015, we exclude captive finance operations from Elisa's consolidated financials. We do not publish our captive finance adjustments for Elisa in table 3, but we report their effect on selected credit metrics. As of Dec. 31, 2017, our captive finance adjustment resulted in improvements of about 0.2x to adjusted debt to EBITDA, approximately four percentage points to adjusted FFO to debt, and three percentage points to FOCF to debt.

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 spectrum acquired in earlier years.

Ratings Score Snapshot

Issuer Credit Rating

BBB+/Stable/A-2

Business risk: Satisfactory

- **Country risk:** Very 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)

Related Criteria

- ARCHIVE - 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
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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-

Ratings Detail (As Of May 21, 2019)*

Elisa Oyj	
Issuer Credit Rating	BBB+/Stable/A-2
Issuer 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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