

### Summary:

## Elisa Corp.

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**Credit Rating:** BBB/Stable/A-2

## Rationale

The ratings on Finland-based fixed-line and mobile telecommunications (telecoms) operator Elisa Corp. (Elisa) reflect Standard & Poor's Ratings Services' view of the company's solid balance sheet, leading and sustainable positions in its domestic markets, and moderately conservative financial policy. The ratings are also supported by management's good track record in rendering the company more efficient and cash generative, which in our view should underpin Elisa's financial risk profile in the medium term.

The ratings are constrained by what we consider to be low growth prospects in Elisa's core markets, which are characterized by high penetration levels for broadband and mobile services and the continued decline of traditional landline services. In addition, there is still fierce competition in Finland, which requires continuous efficiency improvements and cost control.

### Key business and profitability developments

In the second quarter of 2010, Elisa's revenues increased by 2.6% year on year to €364.3 billion. This was mainly due to higher equipment sales volumes and growth in consumer mobile and information and communication technologies services, which offset continued declines in Elisa's fixed line business.

Reported EBITDA increased by 1.8% to €118.5 million in the second quarter, on the back of revenue growth. Personnel expenses increased by 9.9% as staff were added to call centers due to increased customer demand and also due to Elisa's acquisition of Videra, a Nordic video conference company. However, the company reports that this increase in expenses was partially compensated by Elisa's continued efforts to improve operating efficiency. The continuation of operating efficiency efforts in the second half of 2010 could help Elisa to meet its target of a 35% EBITDA margin by the end of 2011. We view this target as ambitious, however, primarily due to the strong competition and relatively low prices in the mature Finnish telecoms market. EBITDA margin in the second quarter was 32.5% compared with 32.8% in the second quarter of 2009.

Elisa has forecast flat revenues and EBITDA in 2010. We view this guidance as realistic because of Elisa's sustainable market positions, good cost-cutting track record, and the likelihood of further growth of mobile subscriptions and the take-up of new services. However, we are mindful of the downside risk that could arise from lower-than-forecast revenues and EBITDA from corporate customers and from the company's mobile operations in Estonia, as well as the costs of developing and launching new services.

### Key cash flow and capital-structure developments

In the 12 months to June 30, 2010, Elisa generated solid free operating cash flow (FOCF) of €237.1 million on a reported basis, which was aided by a positive working capital change of €18.7 million. Elisa expects capital expenditures of 10%-12% of revenues in 2010 compared with 12% in 2009. We expect solid FOCF generation to continue in 2010.

We view the company's financial policy as moderately conservative: It aims to maintain an unadjusted net

debt-to-EBITDA ratio of between 1.5x and 2.0x, an equity ratio of at least 35%, and a dividend payout ratio of 40%-60% of net income. In March 2010, Elisa distributed €143 million in dividends. In addition, in 2009, Elisa obtained permission from the board to buy back a maximum of 10 million shares and to make an additional dividend payment of €100 million. On June 30, 2010, Elisa's credit measures were, in our view, well in line with the ratings. For the 12 months ended June 30, 2010, adjusted net debt to EBITDA stood at approximately 1.7x (1.6x unadjusted.)

### Liquidity

The 'A-2' short-term rating reflects our view that Elisa's liquidity is adequate for its business needs. On June 30, 2010, cash balances stood at €31.6 million and Elisa had €300 million long-term committed revolving credit facilities (RCFs; €170 million due 2012 and €130 million due in 2014), which were both undrawn. Each of the RCFs is provided by five banks and has a maintenance covenant under which Elisa has ample headroom. Elisa generated solid FOCF of €237.1 million in the 12 months to June 30, 2010.

Against these solid sources of liquidity, Elisa had drawings of €110 million under its €250 million noncommitted domestic commercial paper (CP) program (CPP) on June 30, 2010. Elisa has so far been able to refinance upcoming CP maturities, albeit at less favorable conditions than in the past. Short-term debt maturities are modest, with €114.9 million falling due in the next 12 months (including the drawings of the CPP). However, maturities step up in 2011 with the maturity of Elisa's €260 million bond, of which €10 million has been bought and cancelled by the company and €24 million has been bought and held by the company. This leaves €226 million of the bond outstanding.

In connection with a counterparty risk hedging, Elisa provided a maximum \$60 million guarantee, valid until December 2012, for a credit derivative portfolio. Should Elisa be required to pay under this guarantee, this would mean maximum cash payments of \$33 million in 2011 and \$27 million in 2012.

### Outlook

The stable outlook reflects our view that Elisa's profitability, cash flow generation, and treasury management should allow the company to continue to return monies to shareholders while maintaining positive prefinancing cash flow in 2010 and a sufficiently conservative financial risk profile.

We could lower the ratings on Elisa if the company were to make significant shareholder returns, undertake a significant debt-financed acquisition, or if operating performance were to deteriorate significantly such that adjusted debt to EBITDA exceeded 2.3x, which is slightly above Elisa's upper financial policy target of 2.0x unadjusted net debt to EBITDA. We could also take a negative view of any weakening of the company's financial flexibility--notably due to consistently negative prefinancing cash flow and weaker liquidity reserves.

Rating upside potential is limited, in our view, but could arise if Elisa were to significantly improve its profitability. However, this could be difficult to achieve owing to the strong competitive pressure and what we see as limited growth prospects in the mature Finnish telecoms market.

## **Related Criteria And Research**

Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009

Key Credit Factors: Business And Financial Risks In The Global Telecommunication, Cable, And Satellite Broadcast Industry, Jan. 27, 2009

Principles Of Corporate And Government Ratings, June 26, 2007

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