

Global Credit Research - 18 Feb 2011

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

	2007	2008	2009	2010
EBITDA Margin	33.3%	33.7%	35.3%	35.2%
RCF / Adjusted Debt	34.5%	28.1%	27.7%	17.3%
FCF / Adjusted Debt	-1.6%	16.5%	11.9%	-3.3%
Total Debt / EBITDA	1.7x	2.0x	1.8x	1.8x
(FFO+Interest Exp) / Interest Expense	10.9x	8.4x	10.8x	10.0x
(EBITDA-Capex) / Interest Expense	7.4x	5.9x	7.8x	7.6x

[1] Financial metrics as adjusted by Moody's based on FY 2010 preliminary results

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

Opinion

Corporate Profile

Elisa is an integrated provider of telecommunications services to a wide range of consumers and corporate customers in Finland. Principal sources of revenue include voice and data services, connections to the Internet and customised ICT solutions, based on its own fixed and mobile networks. It also operates its own wireless network in Estonia, where it had some 438,200 subscribers as of end-December 2010 and over 25% mobile communications market share. Estonia represents around 6% of total group revenues and EBITDA.

The Finnish state, through its investment arm Solidium, has a 10% stake in Elisa.

Recent Results and Company Events

On 11 February 2011, Elisa reported FY 2010 results, which were in line with Moody's expectations. Revenue grew 2.3% to EUR1,463 million, compared to the 3.6% revenue decline reported in FY 2009. FY 2010 EBITDA was flat at EUR 485 million while reported EBITDA margin slightly declined to 33.2% from 33.8% in the previous year.

In addition, the Board proposed a dividend of EUR 0.90 per share, totaling approximately EUR 141 million, payable in April 2011. The Board also plans to propose to the AGM the approval of a further dividend of EUR 0.4 per share. Therefore, the total dividend payment in 2011 will be around EUR 203 million, compared to EUR 221 million in 2010.

Rating Rationale

The Baa2 rating is based on Elisa's strong positions in Finland's fixed and mobile markets, its very solid financial profile and its conservative financial policy, based on Elisa's stated target of Net Debt/EBITDA in the range of 1.5x to 2x, which Moody's considers to be balanced between shareholder remuneration and creditor protection.

The rating factors in Elisa's relative lack of scale and diversification in an international context, the intense competition that Elisa faces in its

domestic market as well as the modest domestic growth prospects, which could raise pressure for a continued return of cash to shareholders or increase event risk in the form of acquisitions.

DETAILED RATING CONSIDERATIONS

Moody's Rating Methodology for the Global Telecommunications Industry published in December 2010 sets out how Moody's analyses the credit risk of telecommunications companies and arrives at their ratings.

The indicated rating from the methodology grid for Elisa is Baa2, based on the preliminary FY2010 financial results. The outcome is influenced by moderately strong qualitative factors, reflecting Elisa's status as an integrated incumbent in a highly competitive domestic market. These are combined with quantitative factors that reflect solid coverage ratios and relatively low on balance sheet debt as of year-end 2010, but also weaker-than-expected cash flow-to-debt ratios due to the extraordinary dividend payment of EUR77 million in Q4 2010. In common with its peers, Elisa's qualitative factors are not expected to migrate rapidly over the rating horizon. This implies that rating outcomes under the methodology grid are more likely to change as a result of shifting quantitative metrics over the medium term.

Elisa's assigned rating of Baa2, in line with the grid outcome, reflects its prospective nature and also takes account of the group's relative lack of scale, as well as Moody's view that in the medium-to-longer term, modest domestic growth prospects could potentially increase pressure for a continued return of cash to shareholders or otherwise increase event risk in the form of corporate activity. However, we note that the 10% government ownership somewhat mitigates this risk.

Factor 1.

(i) 'Scale' (B). With annual revenues of EUR 1.46 billion (approximately US\$2.0 billion) in 2010, Elisa scores B in this category, which, at 12%, is afforded one of the heaviest single weightings in the methodology grid. This takes account of the credit advantages that larger and more broadly diversified companies enjoy, including lower volatility, reduced risks from an economic downturn in the core market and the flexibility to generate cash from the divestiture of certain assets, if needed. Scale also brings with it significant purchasing leverage, as well as enhancing a company's ability to bundle products, increasingly a competitive advantage. Given the overall size of the Finnish market, Elisa's small scale (despite its strong domestic position) combined with limited geographical diversification into Estonia, is a constraining feature in this category.

(ii) 'Business Model, Competitive Environment and Technological Positioning' (Baa). On the basis of its integrated business in Finland, the intense competitive environment in the domestic market, its low geographical diversification and moderate technology risk, Elisa is categorised as Baa for this factor.

Elisa's wireless revenues represent around 60% of the total balanced by lower market share as wireline incumbent. Overall, Moody's considers an integrated telecom business model such as Elisa's to be more robust than either a stand-alone 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 hedging its exposure to slowing sub-segments, such as fixed voice. The integrated player has a better platform for adopting a range of new products and benefits from the diversity of its business risk.

Competition in Finland remains intense, as is characteristic of the domestic markets of many of the incumbents in Northern Europe. Despite consolidation and a shift away from price towards service, the mobile market remains populated by sufficient numbers of operators (including MVNOs and re-sellers as well as network owners) to ensure competitive intensity remains high and average prices relatively low by European market standards. Nevertheless, we note that in Finland, the independent service providers or MVNO's have a small share of the market (estimated at less than 2%).

Additionally, Moody's sees Elisa's technology risk as moderate. In this regard, Elisa's broadband share and its 3G network coverage, which is the widest in Finland, are important factors to consider. Elisa continues focusing on increasing the capacity and coverage of its 3G network, as a response to the increasing data requirements of smartphones. Furthermore, Elisa has been the first operator to open a 4G network for corporate users and has also been investing in invoice and customer management systems to improve service quality.

In 2010, Elisa's capex/revenue ratio was 12%. The company expects to report a capex/revenues ratio below 12% going forward.

Factor 2.

(i) 'Regulatory and Political' (A). Moody's ranks Elisa in the single-A category, reflecting a combination of factors including relatively modest barriers to entry, and a predictable and well established regulatory/political environment with a long track record.

(ii) 'Market Share' (A). Moody's assigns Elisa an A rating in this category reflecting the strong market shares it retains in the 30%-40% range in both fixed and mobile markets. In particular, the relative success of Elisa's 3G service bundles and overall growth in mobile broadband has helped Elisa gain share in mobile services.

Factor 3. 'Financial Policy' (Baa). Management's strategy and tolerance for financial risk will directly affect debt levels and credit quality and hence is a key rating determinant. Moody's positions Elisa at Baa for this rating factor reflecting its financial policy guidance, which targets a Net Debt/EBITDA ratio of between 1.5x and 2x and is considered balanced between shareholders and creditors, but also reflects the potential for rating migration following acquisitions. We note, however, that Elisa has a track record of being conservative in its approach to acquisitions. The company's other key midterm targets are maintaining an Equity Ratio above 35% and Capex/Sales below 12%.

Factor 4. 'Operating Performance' (Baa). The level and stability of operating margins is a key consideration in assessing risk to debt holders. Moody's positions Elisa at Baa for this rating factor, based on EBITDA margin (as adjusted by Moody's) of 35.2% for 2010. The company has taken actions to improve productivity through cost efficiency measures, mainly coming from the implementation of its One Elisa integration strategy, which involves simplifying processes, and affects areas such as IT consolidation and automation. Nevertheless, these productivity gains have been partially offset by increased sale costs as a result of the growth in the number of mobile subscriptions (467,900 in 2010) and higher churn. In spite of limited growth opportunities in its very competitive domestic market, Elisa's guidance is for slightly improved reported EBITDA (excluding non-recurring items) in 2011.

Factor 5. 'Financial Strength' (A): Moody's methodology shows that Elisa's quantitative factors were overall adequate in 2010, with the exception of its free cash flow (FCF)/debt and retained cash flow (RCF)/debt (mapping to the Caa and B rating categories, respectively) which weakened compared with the ratios reported in 2009 due to the EUR77 million extraordinary dividend payment in Q4 2010. Gross Debt/EBITDA

(as adjusted by Moody's) stood at 1.8x in FY 2010, the same level as in the previous year. As of end-December 2010, reported Net Debt stood at c. EUR 776 million, or 1.6x reported Net Debt/EBITDA. Coverage ratios for 2010 fell comfortably in the Aa range.

In 2011, the company is expected to pay around EUR 203 million to shareholders, a slightly lower amount than the EUR 221 million distributed in 2010 but higher than the EUR 156 million of 2009. This distribution policy is likely to translate into RCF/Adjusted debt at the lower end of the range for the Baa2 rating (between 20% to 30%). However, the relative weakness in this ratio is mitigated by the fact that around 30% of the dividend payment is extraordinary in nature and therefore, the company has more flexibility to cut it if needed.

Liquidity Profile

Following the payment of the EUR 77 million extraordinary dividend announced in October 2010, the company's liquidity has become tighter in light of the large refinancing needs in 2011 (the EUR 226 million bond maturing in September 2011).

This is based upon current expectations for cash flow generation, available cash resources and undrawn credit facilities, compared with cash outflows for debt repayments, capex and committed shareholder remuneration payments. As of YE December 2010, the Group had cash and cash equivalents of EUR 31.8 million, and EUR 268 million in availability under two committed revolving credit facilities maturing in June 2012 and November 2014. These sources, together with expected annual Funds From Operations (FFO) of around EUR 400 million do not fully cover debt maturities of EUR 327 million over the next 12 months (including commercial paper of EUR 102 million), around EUR 190 million of capex and around EUR 203 million of dividends.

The next sizeable material bond redemptions after the EUR 226 million in September 2011 are EUR 75 million in 2013 and EUR 300 million in 2014. Moody's expects Elisa to comfortably address the refinancing of the September 2011 bond maturity and solve any potential liquidity gap in Q1 2011.

Rating Outlook

The stable rating outlook assumes that Elisa will retain strong market positions, and that profitability will improve further against a stabilising, though still very competitive, market background. The stable outlook also assumes that Elisa will perform according to its business plan while maintaining sustainable credit metrics for the current rating category. It also factors in Moody's expectation that the company will maintain an adequate liquidity profile and refinance the September 2010 bond in Q1 2011.

What Could Change the Rating - Up

Over the medium term positive pressure could be exerted on the rating as a result of a sustainable improvement in market shares and profitability together with clearer evidence that domestic market pressures have eased, combined with a track record of financial discipline as evidenced by Net debt/EBITDA (as reported by the company) sustainably below 1.5x and RCF/Adjusted debt above 30%.

What Could Change the Rating - Down

Conversely, any potential unexpected deterioration in market conditions, or larger than expected investments and further returns to shareholders (such that Net debt/EBITDA (as reported by the company) is sustained above 2.0x and RCF/Adjusted debt trends towards 20% without any prospect of recovery) could cause negative rating pressure. Elisa's relatively small scale also exposes the rating to event risk from the possibility of a leveraged bid for the company, although this risk is somewhat mitigated by the 10% government ownership.



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