Moody's Investors Service

Credit Opinion: Elisa Corporation

Global Credit Research - 14 Sep 2009

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**

Elisa Corporation

	2006	2007	2008
EBITDA Margin	**30.5%**	**33.3%**	**33.7%**
RCF / Net Debt	**60.3%**	**35.1%**	**29.1%**
FCF / Net Debt	**8.3%**	**-1.6%**	**17.1%**
Total Debt / EBITDA	**1.1x**	**1.7x**	**2.0x**
(FFO+Interest Exp) / Interest Expense	**13.8x**	**10.9x**	**8.4x**
(EBITDA-Capex) / Interest Expense	**8.1x**	**7.4x**	**5.9x**

[1] Financial metrics as adjusted by Moody´s

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Corporate Profile

Elisa (Baa2) 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 345,900 subscribers as of end-June 2009 and over 20% mobile communications market share. Estonia represents around 5.9% of total group revenues and around 6.5% of group EBITDA.

The Baa2 rating is based on Elisa's strong positions in Finland's fixed and mobile markets, which should help offset the negative impact of intense competition as well as its relative lack of scale in an international context. Elisa has consolidated its position as Finland's largest mobile operator with a subscriber base of 2,806,700 (+15% y-o-y) as of end-June 2009, representing a market share of 38%, closely followed by TeliaSonera which has an estimated 37% and DNA with c. 25%. In the fixed network business Elisa has 1,203,600 fixed-network subscribers (-6% y-o-y at end-June 2009), making Elisa Finland's largest provider (with a share of 34%) of analogue and ISDN access lines as well as broadband services. In common with its peers, the decline in traditional fixed line voice subscribers had been partially offset by growing fixed broadband subscriptions but in the last couple of quarters, partly as a re-focusing of strategy, most of the broadband growth is seen in Mobile broadband, where Elisa is market leader. Cable TV subscriptions were also up 2% y-o-y to 246,500 at end-June 2009.

The Baa2 rating factors in that Elisa continues to implement a three-pronged strategy, with a focus on the integration of One Elisa and strengthening its position in core markets, ahead of expansion into new markets/services. Domestically, there remains scope for further productivity improvements (e.g. through process and systems rationalisation and automation); as well as for improving on customer services (e.g. by enhancing broadband speeds or providing prepaid mobile broadband products), and increasing `share of wallet' in a market which is showing signs of moving away from price and towards service as a key differentiating factor (this includes bundled entertainment initiatives such as advanced digital IPTV products). To the extent Elisa were to begin to expand and invest in new, potentially overseas, markets, the rating assumes this would be on an incremental, manageable basis.

The Finnish state, through its investment arm Solidium, has a 10% stake in Elisa, following the departure of Icelandic fund Novator from the shareholding base in the fourth quarter of 2008.

Rating Rationale

Moody's updated Rating Methodology for the Global Telecommunications Industry published in December 2007 sets out how Moody's analyses the credit risk of telecommunications companies and arrives at their ratings. The methodology examines the core factors that Moody's considers most relevant to telecom operators, sets out the range of possible outcomes by factor and maps these to a rating range. Each factor is appropriately weighted and in combination contributes to the rating output under the methodology grid.

The methodology outcome for Elisa is Baa1, as summarised in the grid below and based on the December 2008 financial statements. 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 on balance map to an A rating, mainly reflecting sound retained cash flow (RCF) generation, solid coverage ratios and relatively low (though increasing) on balance sheet debt as of year-end 2008. 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 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. During 2007, for example, Elisa distributed an extraordinary dividend of approximately EUR 158 million, on top of the payment during 1H2007 of EUR 243 million of special dividends declared in 2006, as well as the purchase of EUR 86 million treasury shares during the first half of 2007. In 2008, Elisa returned EUR 285 million in a capital repayment and EUR 43 million in a share buyback. This has affected Elisa's financial flexibility, and its capacity to make either acquisitions or further returns to shareholders, as well as its ability to absorb the negative impact of any potential unexpected deterioration in market conditions. Elisa's introduction of more leverage into its capital structure has, however, been in line with its stated target of Net Debt/EBITDA in the range of 1.5 to 2 times. In 1H09, dividend distribution amounted to EUR 94 million, on 2008 results. In the current environment, and given management's focus on cash flow generation, Moody's expects any extraordinary shareholder distributions to be limited in consideration of the lower end of the reported leverage target range.

Factor 1. (i) `Size and Scale' (Ba). With annual revenues of EUR 1.48 billion (approximately US$2.18 billion) in 2008, Elisa scores Ba in this category, which is afforded the heaviest single weighting in the methodology grid, at 15%. 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 Finland market, Elisa's small scale despite its strong domestic position combined with limited diversification into Estonia, is a constraining feature in this category.

(ii) `Business Model and Competitive Environment' (Baa). On the basis of its integrated business in Finland, Elisa is categorised as Baa, with its wireless revenues of around EUR 920 million in 2008 representing a little over 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 the network owners) to ensure competitive intensity remains high and average prices relatively low by European market standards.

Factor 2. (i) `Regulatory and Political Framework' (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) `Technology Risk' (Baa). Moody's ratings take account of a company's exposure to technological advancement, and how well-positioned it may be in handling such developments. Also factored in are the potential capital expenditure (capex) implications of any technological improvements and advances. In this regard, Elisa's broadband share and its 3G network coverage, which is the widest in Finland, are important factors to consider. By end-2008, Elisa's 3G network covered over 80% of the population, and total about 250 cities, most of the network having 5 Mbps speeds. Other than in 3G network and enhanced broadband speed and capacity, Elisa has also been investing in invoice and customer management systems to improve service quality. For 2008, Elisa's capex/revenue ratio fell in the 12-15% band (around 11.6% in wireless and around 13.6% in fixed line), which maps to a Baa ranking for this factor, representing moderate risk. Going forward, the company's outlook for investments suggests that this ratio will fall to 10%-12% overall.

(iii) `Market Share' (A). Moody's assigns Elisa an A rating in this category reflecting the strong market shares it retains in the 35%-50% 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: of the total 1 million 3G users in Finland, Elisa estimates it has higher market share in 3G than in overall mobile market..

Factor 3. `Management's Financial Strategy' (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 both its commitment to the One Elisa strategy and 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 and limited additional flexibility for further material shareholder distributions.

Factor 4. `Operating Performance' (Baa). The level and stability of operating margins is a key consideration in assessing risk to debt holders. When considering the scores for this factor, Moody's reviews the EBITDA margin trend as well as the absolute level of EBITDA. Moody's positions Elisa at Baa for this rating factor, based on EBITDA margin (as adjusted by Moody's) at 33.7% for 2008 showing an improving trend from previous years among other things as a result of a change in product mix to new mobile services and efficiency measures which are expected to continue in the medium term. Elisa, nonetheless, faces limited growth opportunities in its very competitive domestic market and company's guidance is for flat EBITDA (excluding non-recurring items) in 2009 and a 35% reported EBITDA margin in 2011.

Factor 5. `Financial Strength' (A): Moody's methodology grid shows that Elisa's quantitative factors were overall adequate in 2008, although reflecting a 11% increase in Gross Adjusted Debt to EUR 1 billion during the year (including capitalised leases of EUR 111 million, an unfunded pension deficit of EUR 2 million and off-balance sheet commitments of EUR 44 million). Debt levels have been increasing over the last couple of years as a result of the significant shareholder distributions and gross leverage (as adjusted by Moody's) has increased to 2x from 1.1x as of end 2006. However, this increase has been moderated by sustained cash flow generation, as shown by RCF/Net Adjusted Debt of 29.1% in the Baa range and Free Cash Flow/Net Adjusted Debt of 17.17% in the A range in Moody's methodology grid for 2008. Coverage ratios for 2008 fell comfortably in the A range.

On the basis of current operating assumptions, in Moody's view, Elisa has limited flexibility under the Baa2 rating to undertake material additional shareholder distributions going forward. Distributions have been aligned to the company's financial reported leverage target of Net Debt/EBITDA in the range of 1.5 to 2 times. As of end-June 2009, reported Net Debt stood at c. EUR 773 million, or 1.6 times reported Net Debt/EBITDA (1.7 times reported as of end-2008). Moody' expects Elisa to exert a degree of prudence in the current economic environment and remain at the lower end of the target range, with any extraordinary shareholder distributions limited as a result.

Liquidity Profile

Moody's considers Elisa's liquidity profile to be adequate to cover its debt maturities and other cash demands over the next 12 months, including capital expenditures (estimated at 12% of revenue, as per company's guidance) and ordinary dividend payments (40-60% payout ratio, as per company's stated policy). This is based upon current expectations for cash flow generation, available cash resources and undrawn credit facilities as well as a reasonable debt maturity profile (next sizeable material bond redemptions amount to EUR 226 million in 2011 and EUR 300 million in 2014). Elisa has a EUR 1 billion EMTN programme and a EUR 250 million CP programme (EUR 575 million and EUR 119 million respectively outstanding at end-June 2009). As of the same date, the Group had cash and cash equivalents of EUR 29 million, and EUR 295 million in availability under two committed revolving credit facilities totalling EUR 300mm and maturing in June 2012 and November 2014, respectively.

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. Free cash flow metrics are expected to partly benefit from positive working capital movements (although perhaps not to the extent of 2008) and Moody's assumes that firmer market conditions and the benefit of ongoing efficiency measures should help underpin sound operational performance in line with company guidance that targets an improving reported EBITDA margin of 35% by the end of 2011. At the same time Moody's considers that the large distributions in 2007 and 2008 have reduced Elisa's financial flexibility, partly utilising its capacity to make acquisitions or further returns to shareholders. In the current environment, Moody's expects management to be prudent in its focus on cash flow generation and moderate leverage in order not to jeopardize the company's ability to absorb the negative impact of any further potential deterioration in market conditions.

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 Free Cash Flow/Adjusted Net Debt approaching 20%.

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 for example sustainable Free Cash Flow/Adjusted Net Debt declined to less than 10% 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.

Rating Factors

Elisa Corporation

Rating factors	Aaa	Aa	A	Baa	Ba	B	Caa
Factor 1: Size, Scale and Business Model							
a) Size and scale					X		
b) Business model and Competitive Environment				X			
Factor 2: Operating Environment							
a) Regulatory and Political			X				
b) Technology Risk				X			
c) Market Share			X				
Factor 3: Strategy and Financial Policies							

a) Management's Financial Strategy				X			
Factor 4: Operating Performance							
a) EBITDA Margin				X			
b) EBITDA Trends			X				
Factor 5: Financial Strength [1]							
a) Total Debt / EBITDA			2.0x				
b) RCF / Adjusted Debt				29.1%			
c) FCF / Adjusted Debt			17.1%				
d) (FFO + Interest Expense) / Gross Interest Expense			8.4x				
e) (EBITDA - Capex) / Gross Interest Expense			5.9x				
Rating:							
a) Indicated Rating from Methodology				Baa1			
b) Actual Rating Assigned				Baa2			

[1] Financial metrics as adjusted by Moody´s