

Elisa Corp.

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Elisa Corp.

Major Rating Factors

Strengths:

- Leading domestic market position.
- Good cost-cutting track record.
- Solid free cash flow generation.
- Moderately conservative financial policy.

Weaknesses:

- Finnish telecoms market's low growth prospects.
- Strong competitive and regulatory pressures.
- Ongoing need for restructuring to sustain margins.
- Structural decline of traditional telephony, and high fixed-to-mobile substitution.

Corporate Credit Rating

BBB/Stable/A-2

Rationale

The ratings on Finnish fixed-line and mobile telecommunications (telecoms) operator Elisa Corp. reflect Standard & Poor's Ratings Services' view of the company's "satisfactory" business risk profile, which is underpinned, in Standard & Poor's opinion, by Elisa's leading and sustainable positions in its domestic market, effective cost optimization, and moderately conservative financial policy. The ratings are constrained by on-going regulatory pressure; market concentration; and our view of low growth prospects and fierce competition in Finland, given high penetration levels for broadband and mobile services and the structural, rapid decline in traditional landline services.

We have not factored any state support into our current rating on Elisa. Consequently, we equalize the rating with Elisa's stand-alone credit profile (SACP), at 'BBB'.

Due to the existence of viable alternative telecoms operators in Finland and the government's small stake in Elisa, we believe that there is a "low" likelihood that the Finnish government would provide timely and sufficient extraordinary support to Elisa in the event of financial distress.

Key business and profitability developments

Elisa's revenues increased by 4.9% year on year in the fourth quarter of 2010, to €383 billion, and by 2% over the full year, to €1.46 billion. The main driver was growth in consumer mobile and equipment sales, as well as in information and communication technologies services, offsetting continued declines in Elisa's fixed-line business.

Reported EBITDA increased by 1.7% year on year in the fourth quarter, and was flat over the full year, while the EBITDA margin eroded somewhat, to 33.2% at year-end from 33.8% the year before. The cost of new services and the impact of a significantly rising churn rate more than offset the benefits of positive revenue growth. Elisa's guidance for 2011 is for a slight increase in both revenues and EBITDA.

We believe that revenues will likely be resistant in the next three years, given Elisa's sustainable market positions and the likelihood of further growth in mobile subscriptions, driven by mobile broadband usage and growing smartphone penetration. This should, in our opinion, help cushion the likely continuous decline in fixed telephony.

Despite Elisa's good cost-cutting track record, we view the company's target of a 35% EBITDA margin by year-end 2011 as increasingly difficult to achieve. This is primarily due to the intense competition and relatively low prices in the mature Finnish telecoms market, as well as ongoing regulatory pressures. That said, we think that continued cost optimization should, at least, effectively mitigate competitive and regulatory pressures.

Key cash flow and capital-structure developments

In the 12 months to Dec. 31, 2010, Elisa generated solid free operating cash flow (FOCF) of about €190 million, and we anticipate continued solid levels in the future. As of end-December, Elisa's credit measures were, in our view, well in line with the ratings, with last-12-month adjusted debt to EBITDA of approximately 1.7x (1.6x unadjusted). We believe that credit metrics will continue to be well within the rating parameters in the next few years, given management's own explicit guidelines and our anticipation of consistently robust FOCF generation.

We view Elisa's financial policy as moderately conservative. The company 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, and in November 2010 it paid an exceptional dividend of €78 million.

Liquidity

We qualify Elisa's liquidity as "adequate," but consider liquidity management to be aggressive, since the company has yet to undertake the refinancing of its bond maturing in September 2011, contrary to our earlier expectations. This translates into tight coverage of one-year maturities with available sources as of end-December 2010.

As of Dec. 31, 2010, cash balances stood at €32 million and Elisa had €270 million of undrawn availability under its long-term committed revolving credit facilities (RCFs): a €170 million facility due 2012 and a €130 million facility (of which about €30 million was drawn) due 2014. Elisa's funding needs for the 12-month period ending Dec. 31, 2011, include a €225 million bond (after buybacks) maturing in September 2011 and about €100 million in outstanding commercial paper drawings.

Still, we believe that the company has solid relationships with core banks and very good access to capital markets; this should enable it, in our opinion, to smoothly implement the refinancing. Also, we note that maturities of outstanding debt are nil in 2012 and 2013. Lastly, the company is listed, and has about 10 million of treasury stock, providing an additional source of flexibility worth roughly €160 million.

We foresee consistently robust FOCF for 2011 as a whole and thereafter, totaling about €200 million annually. However, in our opinion, the majority of these funds will likely be absorbed by dividends and other shareholder distributions.

Each RCF is provided by five banks and has a maintenance covenant under which Elisa has adequate headroom in our view.

Outlook

The stable outlook reflects our opinion that Elisa will smoothly implement refinancing measures in the upcoming months, maintain its well-established market positions despite intense competition, and generate consistently robust FOCF annually. In our view, this should ensure adequate headroom at the current rating level to accommodate likely recurrent exceptional shareholder distributions.

A one-notch upgrade would be possible if adjusted debt to EBITDA were to consistently remain below 2x and the ratio of funds from operations to debt were to remain in the mid to high 40s; we believe this would likely occur if Elisa maintained debt to EBITDA at the low end of its 1.5x-2.x (unadjusted) guidance. However, in our opinion, to warrant an upgrade, we would need to observe as well that the company were less aggressive in its liquidity management than currently, and we would need to have continued confidence that Elisa could sustain its pension- and operating-lease-adjusted operating margins in the mid-30s--and potentially lift the level further--following the gradual improvement seen in the past few years.

We view the possibility of a downgrade as remote at this time, but possible if the company were to make significant shareholder returns, undertake a major debt-financed acquisition, or suffer a material deterioration in operating performance such that adjusted debt to EBITDA exceeded 2.5x.

Government Support And GRE Methodology Impact

The Finnish government (Republic of Finland, AAA/Stable/A-1+) has an indirect 10% stake in Elisa through state-owned holding company Solidium Oy (not rated). We understand that Solidium's mission is to strengthen and then stabilize state ownership in nationally important companies, and to increase the value of its holdings in the long run.

Under our criteria, we view Elisa as a government-related entity (GRE). In accordance with our criteria for GREs, our rating approach for Elisa is based on our view of the company's:

- "Limited" role for the Republic of Finland, due to the existence of viable alternative telecoms operators in Finland; and
- "Limited" link with the state, based on the government's small stake in the company.

Consequently, we believe that there is a "low" likelihood that the Finnish government would provide timely and sufficient extraordinary support to Elisa in the event of financial distress. We have not factored any state support into the current rating on Elisa, which we therefore equalize with the SACP, at 'BBB'.

Business Description

Elisa is one of Finland's leading fixed and mobile telecoms and cable-TV service providers. It is also the No. 3 player in the Estonian mobile market, with a 20% market share, although we view the latter business as small.

Business Risk Profile: A Solid Position In Finland's Saturated, Competitive Telecoms Market

The major supports for what we view as Elisa's "satisfactory" business risk profile are:

- The company's leading and sustainable market positions in Finland, which should, in our opinion, provide it with sufficient scale to achieve solid margins. Unlike most other European markets, the Finnish telecoms market has never been dominated by just one monopoly. The market has many local telephone companies, which have near-monopoly-like characteristics in their traditional service areas. According to the Finnish Communications Regulatory Authority (FICORA), as of June 30, 2010, Elisa was the leading fixed-line telephony operator in the

country, with a 38% market share; the No. 2 broadband operator, with a market share of 30% of all fixed and mobile broadband subscriptions; and the leading mobile operator, with a 38% market share.

- Elisa's position as the dominant fixed-line operator in the Helsinki metropolitan area, which is home to about 25% of Finland's population and is the head-office location for nearly 80 of the country's 100 largest companies.
- A broad state-of-the-art network, with leading mobile coverage in Finland. At year-end 2010, Elisa's third-generation (3G) network covered more than 90% of Finland's population and over 300 cities nationwide. We believe that this should sustain its leading position in the growing market segment of 3G mobile services.
- Bright growth prospects for data traffic revenues--despite high mobile penetration--given increasing penetration of machine-to-machine applications and smartphones.
- Elisa's good cost-cutting track record, which has resulted in consistent margin improvement since 2005 despite ongoing competitive and regulatory pressures on revenues. That said, margins receded somewhat in the third quarter of 2010 compared with the same period of 2009.

These supports are partially offset by what we view as:

- Fierce competition in the small, mature Finnish telecoms market (5.4 million inhabitants), with three infrastructure-based mobile competitors and numerous--though often only locally established--fixed-network operators. As of June 30, 2010, there were about 8.1 million mobile subscriptions in the Finnish market--a very high mobile penetration rate, reflecting the growth in data subscriptions for machine-to-machine applications and mobile broadband.
- Strong fixed-to-mobile substitution, which is resulting in high losses of access lines and declining fixed-line traffic. As of June 30, 2010, the total number of Finnish fixed-line subscriptions had dropped by about 12% year on year to 1.35 million, while call minutes in the six months to June 30, 2010, were down 20% compared with the same period of 2009. In addition, since 2008, mobile broadband subscriptions have been replacing DSL (digital subscriber line) subscriptions. As of June 30, 2010, 43% of broadband subscribers were using mobile broadband, compared with 30% a year earlier, and 43% were using DSL, compared with 54% a year earlier.
- Ongoing regulatory pressure on prices. Mobile termination fees in Finland are among the lowest in Europe. They declined to €0.044 in December 2010, although they have been the same since 2009 for Elisa, Sonera, and DNA Group, thus ensuring a level playing field. Nevertheless, regulation for fixed-line telephony is less stringent than for mobile.

Financial Risk Profile: A Moderately Conservative Financial Policy And Solid FOCF

The main strengths of what we view as Elisa's "intermediate" financial risk profile are:

- A solid balance sheet, primarily due to Elisa's financial policy, which we view as moderately conservative. Management targets an unadjusted net-debt-to-EBITDA ratio of between 1.5x and 2.0x--which we think should translate into a fully adjusted debt-to-EBITDA ratio of less than 2.3x--and an equity ratio of more than 35%;
- Solid FOCF generation, which we believe will likely continue to benefit from Elisa's proactive cost optimization aimed at offsetting the impact of fierce competition and regulatory pressures; and
- Elisa's roughly 10 million treasury shares, which provide an additional source of financial flexibility.

These strengths are moderated, in our view, by:

- The telecoms industry's high capital intensity. Elisa's management targets ongoing annual fixed outlays representing 10%-12% of sales, dedicated to maintaining networks, expanding coverage through investments in additional base stations, and upgrading networks. Compared with that of several European peers, however, the cost for Elisa of acquiring a 2.6 GHz spectrum, fit for new and faster long-term evolution technologies, has been minimal;
- Recurrent extraordinary shareholder distributions; and
- A liquidity policy that we consider to be relatively risky, given a lack of what we would deem to be proactive refinancing decisions well in advance of maturities.

Financial Statistics/Adjustments

Elisa reports in accordance with International Financial Reporting Standards. We add operating leases and unfunded postretirement obligations to Elisa's debt, but deduct the company's cash and short-term marketable securities, since we consider these to be immediately available at the parent level (see table 1). We also adjust debt for a financial guarantee on a credit derivative portfolio, although this adjustment will not be required from 2011 onward since Elisa recently settled the obligation in cash.

Table 1

Reconciliation Of Elisa Corp. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. €)*					
--Fiscal year ended Dec. 31, 2009--					
Elisa Corp. reported amounts					
	Debt	Shareholders' equity	Operating income (before D&A)	Cash flow from operations	Capital expenditures
Reported	749.5	899.2	483.9	431.0	170.3
Standard & Poor's adjustments					
Operating leases	58.5	--	3.7	17.0	11.9
Postretirement benefit obligations	1.3	(1.1)	--	1.2	--
Surplus cash and near cash investments	(31.0)	--	--	--	--
Share-based compensation expenses	--	--	5.2	--	--
Reclassification of nonoperating income (expenses)	--	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	(37.0)	--
Minority interests	--	0.8	--	--	--
Financial guarantee	41.6	--	--	--	--
Total adjustments	70.4	(0.3)	8.9	(18.8)	11.9
Standard & Poor's adjusted amounts					
	Debt	Equity	EBITDA	Funds from operations	Capital expenditures
Adjusted	819.9	898.9	492.8	412.2	182.2

*Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

Table 2

Elisa Corp. Peer Comparison*					
(Mil. €)	Elisa Corp.	Koninklijke KPN N.V.	Telecom Italia SpA	Telekom Austria AG	Portugal Telecom SGPS S.A.
Rating as of Feb. 11, 2011	BBB/Stable/A-2	BBB+/Stable/A-2	BBB/Stable/A-2	BBB/Stable/A-2	BBB/Stable/A-2
Country	Finland	The Netherlands	Italy	Austria	Portugal
--Average of the past three fiscal years (2007-2009)--					
Revenues	1,494.6	13,446.3	29,400.0	4,963.8	6,551.3
Net income from continuing operations	190.8	2,054.0	2,351.0	179.6	652.1
Funds from operations (FFO)	398.7	4,126.6	8,025.4	1,654.2	1,766.2
Capital expenditures	198.5	2,136.6	5,146.2	804.5	1,220.7
Debt	845.7	14,651.3	39,533.1	4,382.1	7,195.9
Equity	935.9	4,172.0	26,811.0	2,116.0	1,905.7
Adjusted ratios					
Operating income (bef. D&A)/revenues (%)	33.4	39.3	40.0	37.6	36.7
EBIT interest coverage (x)	5.8	3.1	2.6	3.0	3.0
EBITDA interest coverage (x)	9.6	6.0	4.7	8.8	5.0
Return on capital (%)	16.2	12.7	9.3	9.4	15.0
FFO/debt (%)	47.1	28.2	20.3	37.8	24.5
Debt/EBITDA (x)	1.7	2.9	3.5	2.4	3.1

*Fully adjusted (including postretirement obligations). Excess cash and investments netted against debt. D&A--Depreciation and amortization.

Table 3

Elisa Corp. Financial Summary*						
--Fiscal year ended Dec. 31--						
(Mil. €)	2010¶	2009	2008	2007	2006	2005
Rating history	BBB/Stable/A-2	BBB/Stable/A-2	BBB/Stable/A-2	BBB/Stable/A-2	BBB/Stable/A-2	BBB/Negative/A-3
Revenues	363.3	1,430.4	1,485.0	1,568.4	1,518.4	1,337.3
Net income from continuing operations	50.7	176.3	176.3	219.8	160.3	176.2
Funds from operations (FFO)	105.2	412.2	383.4	400.6	428.7	351.1
Capital expenditures	44.5	182.2	202.2	211.2	225.5	194.9
Debt	828.6	819.9	920.2	796.9	443.4	357.8
Equity	859.8	898.9	874.0	1,034.7	1,311.6	1,349.6
Operating income (bef. D&A)/revenues (%)	34.8	35.3	33.1	32.1	29.6	26.1
EBIT interest coverage (x)	3.0	6.0	5.0	6.6	8.6	3.6
EBITDA interest coverage (x)	5.3	10.5	8.3	10.3	16.1	9.3
Return on capital (%)	16.0	15.8	15.5	17.4	13.2	8.0
FFO/debt (%)	50.2	50.3	41.7	50.3	96.7	98.1
Debt/EBITDA (x)	1.7	1.7	1.9	1.6	1.0	1.1

*Fully adjusted (including postretirement obligations). Excess cash and investments netted against debt. ¶Nine months ended Sept. 30.

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise noted.

- 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

Ratings Detail (As Of February 11, 2011)*	
Elisa Corp.	
Corporate Credit Rating	BBB/Stable/A-2
Senior Unsecured (6 Issues)	BBB
Corporate Credit Ratings History	
26-Oct-2006	BBB/Stable/A-2
31-Oct-2005	BBB/Negative/A-3
22-Dec-2003	BBB/Stable/A-2
Business Risk Profile	Satisfactory
Financial Risk Profile	Intermediate
Debt Maturities	
As of Dec. 31, 2010	
2011: €327 mil.	
2012: 0	
2013: 0	
2014: €310 mil.	
Thereafter: €40 mil.	

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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