This Analysis provides a discussion of the factors underpinning the credit rating/s and should be read in conjunction with our Credit Opinion. The most recent ratings, opinion, and other research specific to this issuer are provided on Moodys.com. ***Click here to link.***

Analysis

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Elisa Corporation

Corporate Profile

FINLAND'S INTEGRATED TELECOMUNICATIONS OPERATOR

Elisa Corporation (Elisa, rated Baa2, stable outlook) is an integrated provider of telecommunications services in Finland. Elisa offers wireline voice and data services, wireless communication services and Internet-related services based on its own fixed and mobile networks.

Elisa is Finland's largest provider of analogue and ISDN access lines as well as broadband services. Due to the geographically fragmented nature of the Finnish fixed-line industry, Elisa controls only around 34% (1.19 million access lines) of the Finnish market, including the metropolitan area of Helsinki. Its main competitor TeliaSonera Finland (formerly Sonera), rated Baa1 with positive outlook, has circa 23% market share covering other geographical areas, with the remaining 40% controlled by local telecom operators.

Elisa's fully owned subsidiary Elisa Mobile (formerly Radiolinja) is the second-largest mobile operator with market share of approximately 30% (1.35 million subscribers), where TeliaSonera Finland is the leader with over 50% market share. Elisa Mobile also owns 99% of Radiolinja Eesti, the third-largest mobile operator in Estonia with market share of around 17% (168,000 subscribers).

DISPOSAL OF THE GERMAN OPERATION HAS IMPROVED BUSINESS AND FINANCIAL PROFILE

Through its 100% owned subsidiary Elisa Kommunikation GmbH, Elisa had a 65.9% stake in Tropolys, which in turn held controlling stakes in a number of city carriers in Germany. In May 2004, the sale of Elisa Kommunikation GmbH to a consortium led by Apax Private Equity Funds was approved by the German competition authority (the *Bundeskartellamt*). Elisa received €30 million in 2Q 2004 from the transaction and a further €40 million will be received between 2006 and 2008. In Moody's view, the disposal of the loss-making German operation is clearly an improvement to Elisa's business and financial risk profile (see Business Risk Factors section).

Figure 1 - Operational Highlights*

FY ended 31 December	Revenue			EBITDA		EBITDA Margin	
(€ million)	2002	2003	Change	2002	2003	2002	2003
Mobile	739	762	3.1%	194	215	26.3%	28.2%
Fixed Network	735	677	-7.9%	213	204	29.0%	30.1%
German City Carrier	118	134	13.6%	-21	4	-17.8%	3.0%
Other/ Eliminations	-29	-35	N/A	-44	-16	N/A	N/A
Total	1,563	1,538	-1.6%	342	407	21.9%	26.5%

** Figures adjusted for non-recurring items.*
*** Source: Elisa.*

In the 1880s, Elisa started as an incumbent telephone operator in the City of Helsinki, and since the 1920s has gradually expanded into other regions by acquiring smaller local and regional telecom operators. As a result of its long history of serial acquisitions, Elisa currently has more than 100 subsidiaries. This complicated group structure will be simplified under the "One Elisa" approach recently initiated by management (see section entitled Management Strategy). There is no material debt at the subsidiary level, and Moody's rating factors the expectation that Elisa will continue to operate on a centralised financing basis.

Elisa is listed on the Helsinki Stock Exchange. Institutional investors own 63% of shares with the remaining 37% owned by households, and no single investor owns more than 3% of the group.

Figure 2 - Ownership Structure

10 Largest Shareholders (as of 31 May 2004)	Holding % of votes
Sampo Life Insurance Company Ltd	2.90%
Varma-Sampo Mutual Pension Insurance Company	1.96%
Ilmarinen Mutual Pension Insurance Company	1.76%
State Pension Fund	1.01%
City of Helsinki	0.81%
Mutual Insurance Company Kaleva	0.80%
State Treasury	0.72%
Local Governments Pensions Institution	0.61%
Mutual Pension Insurance Company Tapiola	0.60%
ETERA Pension Fund	0.44%

** Source: Elisa.*

Management Strategy

FINLAND IS ELISA'S MAIN MARKET

Management has clearly stated that Elisa will remain focused on its domestic wireline and wireless markets. The only exception is Estonia, where Elisa has wireless operations through Elisa Mobile. The Estonian business has been profitable for the past two years and management believes that this business provides synergies with Elisa's Finnish operations. Otherwise, we would expect that management will pursue profitable organic growth in Finland for the immediate future.

MANAGEMENT MANDATE IS TO IMPROVE PROFITABILITY

After a prolonged period of weak share performance a new management team was brought in in July 2003. Elisa's share price had fallen by 75% between 1 January 2001 and 31 December 2002. In part, the poor share performance reflected the suspension of dividends due to weak profitability (see Financial Risk Factors section). Elisa's poor share performance also reflected a relatively weak operating performance[1] along with potential concerns regarding the company's expansion into the German city carrier market (Elisa acquired Tropolys in January 2002). The new management team's main objective has been to improve group profitability and cash flow through operational restructuring and the disposal of non-core assets.

In 2004, management has set out to reorganise the group structure under what it has termed "One-Elisa" approach, which involves the merger of all domestic core companies into Elisa Corporation. These operations will be integrated into three new business units, namely Customer, Product and Network, rather than the traditional grouping such as fixed-line and mobile. The reorganisation also involves rebranding of group products and services under one brand, "Elisa". As such, the Radiolinja mobile brand will be replaced with Elisa Mobile. Management believes that the reorganisation will help Elisa to improve customer-oriented marketing, as well as benefit from operational synergies (see below).

Management has already started a restructuring programme, targeting €80 million of annual cost savings by the end of 2005. As the first step, in January 2004 Elisa concluded employee negotiations, agreeing to cut about 760 permanent jobs and 140 temporary jobs during 2004. After one-off restructuring charges of approximately €25 million, Elisa expects to achieve €40 million of annual savings from the staff reduction as a result of lower salaries, travel expenses and training costs, amongst others. Furthermore, through the group reorganisation, management plans to extract synergies by centralising product management and procurement, integrating IT systems and sharing overhead functions.

1. *Elisa's operating margin has underperformed vis-à-vis its peers - i.e. in 2002 Elisa's EBITDA margin was 22.2% compared to 34.3% for TeliaSonera Finland.*

After the sale of its German city carrier business, Elisa will have the following non-core assets:

(1) 58% stake in Comptel (software development and system services)

(2) 100% stake in Estera (real estate IT solutions)

(3) 33% indirect stake in Yomi Software (100% after Yomi mergers into Elisa on 31.12.2004)

(4) Real estate (the former Elisa and Radiolinja headquarters)

Due to uncertainty as regards the size and timing of future divestments, we do not factor any disposal of the aforementioned assets into our analysis.

LONG-TERM STRATEGY HAS YET TO BE COMMUNICATED

Whilst Moody's expects that management will focus on operational improvement for the time being, we note that long-term strategy has yet to be communicated. Growth prospects are limited and therefore Moody's expects that shareholder pressure could increase over time, which could lead to a high cash payout to shareholders or event risk (positive or negative) in the form of a merger or other business combination. The Board is currently reviewing long-term strategic options for the group, which are expected to be concluded by September 2004. In its 2003 Annual Report Elisa stated that no dividends will be paid for that year.

Key Rating Considerations

IMPROVED FINANCIAL PROFILE OFFSET BY INCREASED COMPETITIVE PRESSURE

In March 2003, Moody's downgraded Elisa's long-term senior unsecured rating to Baa2 (Stable outlook) from A3 (Negative outlook). This action was based upon Moody's perception of Elisa's weakened business profile due to the heightened competition in its core markets, as well as weaker financial flexibility resulting from a sharp fall in the share price and continued losses in its German and other non-core operations.

Since then, the new management team has focused on operational restructuring and asset disposals (including the sale of its German business), which have contributed to improved profitability and cash flow. However, Moody's believes that Elisa faces continued pressure from fixed-to-mobile substitution in its fixed-line business and intensified competition mainly from service providers in its mobile business. Moody's also factors negatively Elisa's relatively small scale, in that (1) it operates primarily in Finland and (2) it is an incumbent operator, but does not have a full coverage of Finland. Moody's expects that Elisa's management will continue to focus on operational improvement, and that the main part of restructuring will be largely completed by the end of 2004 with EBITDA margin stabilising between 30% and 35%.

Business Risk Factors

ELISA'S MOBILE BUSINESS FACES INCREASED COMPETITION

The Finnish wireless market is highly competitive, with three network operators and a number of service providers (resellers). Slow growth due to high penetration (93%), together with the introduction of number portability in July 2003, has intensified competition and price erosion. In particular, service providers operating in the low-rate subscription segment have increased their market share through aggressive campaigns. ACN and Saunalahti, the two leading service providers, resell TeliaSonera Finland's network, whereas Elisa's presence in the segment has been negligible.

Since its commercial launch in 18 November 2003, ACN gained 225,000 subscribers by 31 March 2004. In Q1 2004, Saunalahti increased subscriber numbers by circa 70,000 to 214,000 (on a quarter-on-quarter basis). During the same period, Elisa lost circa 55,000 subscriptions or 4% of its customer base. Despite launching its own low-rate product, Kolumbus, in March 2004, Moody's expects Elisa to continue to experience market share erosion for the rest of the year.

Moody's does note that Elisa - despite the loss of its market share - has largely been able to maintain its average revenue per user (ARPU) by growth in usage via offering new services such as e-mail, picture messaging and browsing services. Moody's also factors positively Elisa's strategic partnership with Vodafone, which enables it to offer a broad range of data services and international roaming.

Figure 3 - Mobile Sector Development

	2003	1Q 2003	1Q 2004
Revenue (€ million)	762	175	179
EBITDA Margin (%)*	28.2%	24.6%	36.9%
Number of subscriptions	1,374,146	1,348,183	1,319,007
ARPU (€)	41.6	38.5	38.6
Churn (%)	18.6	14.4	47.4
MoU (millions of minutes)	2,310	531	596
SMS (millions of messages)	453	109	121
Value-added service/ revenue (%)	12	13	13

** Adjusted for non-recurring items.*

*** Source: Elisa.*

FIXED-LINE BUSINESS IS UNDER SUSTAINED PRESSURE

The Finnish telecoms market is distinguished by a high level of fixed-to-mobile substitution, as circa 35% of the households use only mobile phones. The continued fixed-to-mobile substitution is exerting pressure on Elisa's fixed-line subscriptions and revenue, which is only partially offset by the rapid growth of broadband subscriptions. During Q1 2004, the number of PSTN and ISDN lines fell by 7.5%, which drove revenue down by 5% year-on-year. Despite falling revenue, Elisa has largely maintained its operating profitability, thanks to improved efficiency and cost control.

Figure 4 - Fixed-line Development

	1Q 2003	2Q 2003	3Q 2003	4Q 2003	1Q 2004
Revenue (€ million)	170	175	163	169	164
EBITDA Margin (%)*	30.6%	28.6%	30.7%	30.8%	31.7%
Broadband subscriptions (lines)	81,871	93,677	107,875	127,388	148,270
Cable TV subscriptions (lines)	172,400	176,506	179,858	183,469	186,097
ISDN channels (lines)	229,252	222,153	211,510	200,455	190,921
PSTN and other subscriptions (lines)	700,789	688,672	683,159	675,272	669,192

** Adjusted for non-recurring items.*

*** Source: Elisa. The 1Q 2004 figures are not fully comparable with previous quarters.*

In 2003, monthly charges for broadband fell to €35-50 from €50-60 due to intensified competition. Whilst Moody's expects the demand for broadband subscriptions in Finland to remain strong in 2004, we also expect ongoing pressure on broadband prices. Therefore, we expect sustained pressure on the fixed-line revenue for the foreseeable future. We also note that, in face of a difficult market environment and ongoing consolidation, as evidenced by the TeliaSonera merger, Elisa may come under pressure to increase scale through a form of merger or other business combination.

DISPOSAL OF GERMAN BUSINESS IS A POSITIVE DEVELOPMENT

Following substantial investments, Elisa's German city carrier business has yet to become free cash flow positive. Despite turning profitable at operating level (EBITDA of €4 million) in 2003, the German unit has been a significant drag on Elisa's financial flexibility in terms of negative cash flow and future required investments. The sale of the German business will not only improve Elisa's future cash flow but also reduce net debt by circa €45 million and off-balance sheet debt by €110 million.

Financial Risk Factors

IMPROVED PROFITABILITY UNDERPINS HEALTHY CASH FLOW GENERATION DESPITE REVENUE DECLINE

In 2003, total revenue decreased by 1.6%, with the decline in fixed-line revenue (7.9%) only partially offset by growth in mobile revenue (3.1%). In 2004, Moody's anticipates increased competition in the mobile sector and continued pressure on fixed-line business, and therefore we expect a slight decline in group revenue on a like-for-like basis (adjusted for the disposal of the German city carrier unit). However, Moody's expects that continued operational restructuring and headcount reduction will have a positive impact on Elisa's profitability, contributing to stable cash flow generation. During 2004, we expect around €300 million of retained cash flow to be generated, with the level of capital expenditure broadly in line with that of the previous year.

FIGURE 5 - Revenues and Profitability

FY ended 31 December (€ million)	2001	2002	2003
Net Revenue	1,439	1,563	1,538
Growth	15.7%	8.6%	-1.6%
EBITDA*	325	347	445
Margin	22.6%	22.2%	28.9%
EBIT* **	112	92	172
Margin	7.8%	5.9%	11.2%
Amortisation of goodwill and write-downs	-45	-59	-145
Net Interest	-48	-50	-40
Exceptionals	41	-78	-60
Net Income	1	-71	-17

** Adjusted for non-recurring items and other income.*

*** Before goodwill amortisation and write-downs.*

**** Source: Elisa and Moody's analysis.*

SUSPENSION OF DIVIDENDS DUE TO WEAK PROFITABILITY

Elisa has not paid dividends since 2001, due to the continuation of weak operating performance and profitability. Its inherited dividend policy is to pay out 40% of net income. The board is currently reviewing Elisa's future distribution framework as part of its long-term strategic review. The company is not considering share buyback in the foreseeable future.

FIGURE 6 - Cash Flow

FY ended 31 December (€ million)	2001	2002	2003
OPERATING CASH FLOW	366	320	315
Interest paid	-57	-50	-46
Interest received	9	0	6
Tax paid	-42	3	60
Change in net working capital	26	32	-30
GROSS CASH FLOW	302	305	305
Dividends paid	-15	-4	-2
RETAINED CASH FLOW	287	301	303
Net capital expenditures	-344	-262	-189
FREE FUNDS	-57	39	114
Net investments	-21	46	-11
PRE-FINANCING CASH FLOW	-78	85	104
Debt financing, net	141	-141	-102
Equity financing, net	8	18	0
NET INCREASE IN CASH AND CASH EQUIVALENTS	72	-38	1

** Source: Elisa and Moody's analysis.*

LEVERAGE TO REMAIN MODEST

Over the past two years Elisa has reduced the level of net debt by over €100 million, which has led to improved credit metrics. Assuming that management will maintain its conservative financial policy, we expect modest leverage and further improvement in credit metrics in 2004. At the end of 2003, Elisa had approximately €225 million of operating leases and €37 million of contingent liabilities, which has been factored into Moody's analysis.

Figure 7 - Leverage and Credit Ratios

FY ended 31 December (€ million)	2001	2002	2003
Short-term debt	289	66	110
Long-term debt	580	704	597
Total debt	869	771	707
Cash and short-term investments	104	73	67
Net debt	765	698	639
Other net debt adjustments:			
Pensions, operating leases, contingencies etc.	246	249	262
Adjusted net debt	1,011	947	901
RCF adjusted / Adjusted net debt	31%	34%	42%
FFO adjusted interest coverage	6.3	7.1	7.7
Free funds adjusted / Adjusted net debt	-3%	6%	21%

** Source: Elisa and Moody's analysis.*

ADEQUATE LIQUIDITY THANKS TO POSITIVE CASH FLOW

Elisa has a liquidity structure that is sufficient to cover its debt maturities and other cash demands based on existing cash balance and internally generated funds.

As of 31 March 2004, Elisa had circa €68 million of cash and short-term investments. We estimate that Elisa will generate over €100 million of free cash flow over the next 12 months. Furthermore, Elisa has received €30 million in cash from the sale of its German operations. Assuming no additional investments, Elisa's liquidity would be sufficient to cover maturing debt and other cash demands, which we estimate to be less than €150 million.

Elisa has €170 million of undrawn committed bank credit line - valid until 2008. The facility contains a material adverse change (MAC) clause. Elisa has over €300 million of debt maturing in 2006, and management intends to refinance a part of it to lengthen its debt maturity profile.

Related Research

User's Guide:

Moody's Basic Definitions for Credit Statistics, User's Guide, June 4, 2003

Industry Outlook:

European Investment-Grade Telecoms Operators, December 2003 (80741)

Special Comment:

Moody's Telecom Quarterly Review 4th Quarter, 2003, March 2004 (81757)

Mobile Telecom Alliances in Europe: Key Strategic Decision or Marketing Hype?, October 2003 (79815)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Financial Statement Ratios

Financial Statement Ratios: Elisa Corporation

To access any Financial Statement Ratios click on the entry above or to download Financial Statement Ratios in .csv format.

Description	Coupon (%)	Currency	Face Amount (mil)	Maturity	Moody's Rating
Elisa Corporation					
Issuer Rating	—	—	—	—	Baa2
Flt Rt Euro Medium Term Notes	—	EUR	100	2004	Baa2
Euro Medium Term Notes	6.375	EUR	300	2006	Baa2
Flt Rt Euro Medium Term Notes	—	EUR	20	2007	Baa2
Flt Rt Euro Medium Term Notes	—	EUR	10	2007	Baa2
Flt Rt Euro Medium Term Notes	—	EUR	30	2008	Baa2
Flt Rt Euro Medium Term Notes	—	EUR	20	2009	Baa2
Flt Rt Euro Medium Term Notes	—	EUR	10	2009	Baa2
Flt Rt Euro Medium Term Notes	—	EUR	10	2009	Baa2
Euro MTN Program	—	EUR	1,000	—	Baa2

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