

## Telekom Austria

Telekom Austria Outlook Revised To Positive On Sound Performance; 'BBB+/A-2' Ratings Affirmed

S&P Revises Telekom Austria Otlk To Pos; Afrms 'BBB+/A-2' Rtg

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### ***Rationale***

On Aug. 1, 2006, Standard & Poor's Ratings Services revised its outlook on Austrian telecommunications operator Telekom Austria AG to positive from stable. At the same time, the long- and short-term corporate credit ratings were affirmed at 'BBB+' and 'A-2'. This follows a review of the group's business prospects and financial plans.

***Publication Date***

Aug. 1, 2006

The outlook revision reflects Telekom Austria's sound operating performance, strengthened cash flow profile, and conservative financial policy.

Telekom Austria's domestic operating performance remains sound. Specifically, the group has stabilized its domestic voice market share and retains a significant market share in asymmetric digital subscriber lines (51.5%), despite competitive, regulatory, and technology pressures.

Telekom Austria's domestic mobile operation is also managing relatively well in a very competitive marketplace exposed to regulatory pressure on mobile interconnection tariffs. The group's international mobile operations, which have grown considerably both organically and through acquisitions over the past few years, have significantly strengthened the group's free cash flow generation profile. These strengths have translated into sound performance, with consolidated free cash flow generation of about EUR 1 billion in 2005 (under IFRS and with only six months consolidation of Bulgarian operator Mobiltel EAD) and a strong operating margin of 43.5% on revenues of EUR 1.2 billion in the first quarter of 2006.

On the back of stronger free cash flow generation, Telekom Austria has the necessary financial flexibility to fund a certain level of acquisitions, dividends, and share buybacks while maintaining conservative debt ratio targets. The group increased its dividend payout ratio to 65% in 2005 and has a share buyback program in place for up to 10% of its common stock for the 2005-2007 period, of which about 5.5% has been implemented so far. On July 31, 2006, Telekom Austria withdrew from the bid process to buy Serbian mobile operator Mobi63 because the price was outside the group's expectations and financial policy. This withdrawal is expected to accelerate the implementation of management's share buyback plan. In addition, Telekom Austria continues to be interested in buying Telecom Srpske, based in Bosnia-Herzegovina, which is soon to be privatized. We expect that the group's shareholder return and acquisitions strategies will continue to be consistent with its clear financial policy of maintaining unadjusted net debt to EBITDA of 2x (this ratio was 1.75x at Dec. 31, 2005). On a Standard & Poor's adjusted basis (that is, adjusting for operating leases, employee benefit obligations, asset-backed securitization, and cross-border leases), and pro forma for 12 months consolidation of Mobiltel, we calculate this ratio at about 1.8x at the same date.

### ***Liquidity/Short-term credit factors***

Telekom Austria's liquidity was strong at March 31, 2006, with access to EUR 1.8 billion of committed or agreed lines of credit, of which EUR 282 million was drawn. Liquidity is also supported by strong free cash flow generation. The group's debt maturity profile is unchallenging.

## ***Outlook***

The positive outlook reflects the possibility of an upgrade over the medium term if Telekom Austria maintains its strong business risk profile and financial policy. Specifically, we expect the company to successfully defend its leading domestic market positions and integrate Mobiltel, and to maintain strong operating margins and solid free cash flows. A higher rating would require the maintenance of a Standard & Poor's adjusted net debt-to-EBITDA ratio that does not materially exceed 2x as well as continuing strong free cash flow generation.

Conversely, although less likely in our view, an unexpected material deterioration of Telekom Austria's domestic operations or a financial policy that is less conservative than expected could trigger a revision of the outlook back to stable.

## ***Ratings List***

| To  | From            |
|---|-----------------|
| Corporate credit rating BBB+/Positive/A-2 | BBB+/Stable/A-2 |

NB: This list does not include all ratings affected.

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