STANDARD & POOR'S RATINGS SERVICES

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Summary:

Telekom Austria AG

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Credit Rating:	BBB/Stable/A-2

Rationale

The ratings on Telekom Austria AG reflect Standard & Poor's Ratings Services' view of the group's "satisfactory" business risk profile and "intermediate" financial risk profile.

Telekom Austria's business risk profile is supported, in our view, by its sustainable leading market positions in the Republic of Austria. Furthermore, the group's international mobile operations help diversify its revenue base and generate meaningful profit margins. These factors are tempered by the saturation of, and fierce competition in, Austria's declining telecommunications services market, in our opinion. We also consider that the group's international mobile operations continue to face meaningful competitive and regulatory pressures and significant country risks, notably in Belarus. We also note that Telekom Austria has a rigid cost structure because of the high number of civil servants working at its domestic fixed-line business. We assess the company's management and governance as "satisfactory" under our criteria.

Telekom Austria's financial risk profile is primarily supported by the group's transparent and moderately conservative financial policy, which targets a ratio of net debt to comparable EBITDA (before restructuring costs and impairments) of about 2.0x. The group has been also taking measures to support its current 'BBB' rating in the face of higher competition in Austria, still unfavorable economic conditions in its main markets, and potentially large investments in radio frequency spectrum during 2013. In September 2012, the group cut its dividend per share by 87% to €0.05 for the fiscal years 2012 and 2013 and, in January 2013, it announced the issuance of a hybrid bond. These measures protect Telekom Austria's discretionary cash flow (DCF; cash flow from operations after capital expenditures and dividends) and credit metrics. At the same time, Telekom Austria faces notable foreign exchange exposure from its international operations in Belarus, Serbia, and Macedonia, which could reduce its cash flow generation.

S&P base-case operating scenario

In our base-case assessment, we expect the group's revenues to decline by about 3% in 2012, by 2%-3% in 2013, and to stabilize in 2014. In our view, continued fierce competitive and regulatory pressure in Austria and Bulgaria as well as still weak economic conditions in its services areas are likely to burden group revenues in 2013. These pressures will be only partly offset by higher revenues at Telekom Austria's mobile operations in Serbia and Macedonia. In addition, we currently forecast modestly higher revenues in Belarus, following the stabilization of the Belarusian ruble-to-euro exchange rate at Belarusian ruble (BYR) 10,000-BYR11,000 to €1 during 2012. In the first nine months of 2012, Telekom Austria reported a modest year-on-year revenue decline of 0.8% for its mobile operation in Belarus.

We expect relatively stable revenues in 2014, primarily due to our expectation of less fierce competition in the Austrian mobile market following the recent market consolidation and the company's announced investments in high-value mobile customers in Austria during 2013. In addition, we expect that competitive pressures on revenues will be offset by a more favorable economic environment and we forecast a diminishing negative impact on revenues from mobile termination rate cuts.

Depending on the size of the group's investments in the Austrian mobile market and ability to achieve further cost savings, we expect the group's comparable EBITDA margin, as adjusted by Telekom Austria, to decline a few percentage points in 2013 from about 34% in 2012, but to recover gradually thereafter as market investments in Austria are reduced and revenues stabilize.

S&P base-case cash flow and capital-structure scenario

In our base-case assessment, we forecast DCF of about €200 million to €250 million in 2012 and a similar level in 2013 before any spectrum investments, up from €142 million in 2011. In our view, the dividend cuts in 2012 and 2013 will largely offset the expected decline in EBITDA. In addition, our forecast assumes slightly lower capital expenditures, excluding spectrum investments, of €0.7 billion in 2012 and 2013, compared with €739 million in 2011.

We anticipate the group's net debt-to-EBITDA ratio, after our adjustments, to increase slightly to 2.7x at year-end 2012 from 2.6x (2.2x as adjusted by Telekom Austria) as of Sept. 30, 2012, primarily due to the completion of the acquisition of assets from mobile operator Orange Austria Telecommunication GmbH for up to €390 million in January 2013.

We also calculate that the group's leverage (after our adjustments) could exceed 2.8x at the end of 2013, because the anticipated deleveraging effect from the proposed hybrid bond issuance could be more than offset by the expected decline in group EBITDA and cash outflows from the acquisition of fourth-generation (4G) spectrum in Austria (please see "Telekom Austria AG Proposed Junior Subordinated Hybrid Securities Assigned 'BB+' Issue Rating," Jan. 21, 2013, for more details of the issuance). Nevertheless, the amount and timing of any spectrum investments are still unclear at this stage. In addition, we foresee meaningful deleveraging potential for the group in 2014 in our base case, primarily as a result of positive discretionary cash flow.

Liquidity

The short-term rating on Telekom Austria is 'A-2'. We assess the group's liquidity profile as "adequate," as defined in our criteria, and forecast that liquidity sources will exceed uses by more than 1.2x in the 12 months from Sept. 30, 2012, and in 2013.

In our base case, we estimate Telekom Austria's liquidity sources in the 12 months from Sept. 30, 2012, in excess of €3.0 billion. These include primarily:

- Surplus cash of about €0.6 billion. We consider a large part of the group's available cash and short-term investments to be surplus cash, assuming that only €50 million is required for operations. We assume that the group will continue to be able to repatriate cash from Belarus, which was, however, not the case for a few months in 2011. As of Sept. 30, 2012, the group's cash balances and available short-term investments stood at €634 million;
- About €1.1 billion available under various committed credit facilities, maturing after 2015, including a new five-year €735 million syndicated credit facility without financial covenants granted in July 2012; and
- Positive funds from operations of about €1.1 billion.
- Meaningful proceeds from the proposed hybrid bond issuance.

We estimate the group's liquidity needs in the 12 months from Sept. 30, 2012, at in excess of €2.1 billion, mainly including:

- Debt maturities of about €850 million; in the full year 2013, the group faces debt maturities of €1.0 billion, but only €0.1 billion in 2014;
- Capital expenditures of about €0.7 billion;
- About €0.4 billion of cash outflows related to the acquisition of assets from Orange Austria and modest deferred payments related to previous acquisitions;
- Potentially large spectrum investments in Austria;
- Moderate working capital outflows of about €0.1 billion; and
- Annual shareholder dividends of €22 million.

Outlook

The stable outlook reflects our belief that Telekom Austria should be able to generate positive DCF excluding spectrum investments of about €0.25 billion annually and maintain an adjusted debt-to-EBITDA ratio of about 2.5x-2.6x, excluding spectrum investments. We also expect the ratio of adjusted funds from operations to debt to be in the low 30s. In addition, we believe the group will defend its solid domestic and nondomestic market positions and improve its domestic EBITDA generation in 2014 compared with 2013 as a result of the current consolidation in the mobile telephony market and its planned investments in high-value mobile customers.

Pressure on the rating could build if the group were to report continued declines of comparable EBITDA beyond an expected low-point in 2013, or if DCF turned negative for more than one year. In addition, a negative rating action could stem from large debt-financed acquisitions or significant investments in spectrum that resulted in a pro forma adjusted debt-to-EBITDA ratio of more than 2.75x, accompanied by limited prospects to reduce leverage within 12 months.

Although unlikely in the near term, we would consider an upgrade if we believed the group could stabilize its revenues and improve its comparable EBITDA margin to more than 35%. A positive rating action would also likely depend on significant positive DCF generation and a net debt-to-EBITDA ratio, after our adjustments, of about 2x.

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal.

- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Methodology: Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- Telekom Austria AG Proposed Junior Subordinated Hybrid Securities Assigned 'BB+' Issue Rating, Jan. 21, 2013

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