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Standard & Poor's Research

Telekom Austria AG

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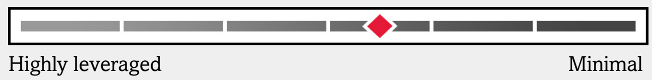
Telekom Austria AG

Corporate Credit Rating	BBB/Stable/A-2

Profile Assessments

BUSINESS RISK	SATISFACTORY	
FINANCIAL RISK	INTERMEDIATE	

Likelihood Of Extraordinary Government Support

The 'BBB' rating on the government-related entity (GRE) Telekom Austria AG is based on Standard & Poor's Ratings Services' assessment of the company's stand-alone credit profile (SACP) at 'bbb'. In addition, the rating reflects our expectation of a "low" likelihood of timely and sufficient extraordinary support, in the event of financial distress, from the company's 28.4% shareholder, the Republic of Austria (unsolicited AA+/Stable/A-1+). The rating on Telekom Austria is therefore at the same level as the SACP.

In accordance with our criteria for GREs, our rating approach is based on our view of Telekom Austria's:

- "Limited" role for Austria, due to the existence of viable alternative telecom operators in Austria. In addition, in our opinion, the Austrian government is more interested in the stability of the group's operations than the group's credit standing; and
- "Limited" link with the state, based on our view that the Austrian government is unlikely to be a long-term owner. Austria's investment and privatization agency, Oesterreichische Industrie Holding AG (OIAG), pursues a dual strategy in carrying out its role. It aims to increase the value of its holdings, but also monitors its investments for exit scenarios. Depending on its mandate from the Austrian government, OIAG also seeks to partly or fully privatize its companies.

Rationale

Business Risk: Satisfactory	Financial Risk: Intermediate
• Leading telecommunications operator in Austria. • Profitable and cash-generative international mobile operations. • High competitive and regulatory pressure in many service areas. • High exposure to country risk, especially in Belarus. • Rigid cost structure in Austria.	• A transparent and moderately conservative financial policy. • Expectations of solid operating cash flow generation. • Leverage metrics at the upper end of our expectations for the rating. • Marked foreign exchange exposure of cash flows from international operations in Belarus, Serbia, and Macedonia.

Outlook: Stable

The stable outlook reflects our belief that Telekom Austria should be able to generate positive discretionary cash flow (DCF), excluding annual spectrum investments of at least €0.25 billion, and maintain a Standard & Poor's adjusted debt-to-EBITDA ratio of about 2.6x in 2014. We also expect the ratio of adjusted funds from operations (FFO) to debt to be in the low 30 percents. In addition, we believe the group will improve its domestic EBITDA generation in 2014 compared with 2013, owing to the current consolidation in the mobile telephony market and its planned investments in high-value mobile customers. As a result, we expect at worst a stabilization of the group's blended monthly mobile average revenues per user (ARPU) at about €16 to €17, compared with €18.4 in 2012.

Downside scenario

We might consider a downgrade if Telekom Austria were to report continued declines of comparable EBITDA (see Key Metrics table below) beyond the low we expect in 2013, due to continued price competition on mobile ARPU and insufficient cost cuts. In addition, we could lower the rating if DCF turned negative for more than one year. A negative rating action could also stem from significant investments in spectrum that resulted in a Standard & Poor's adjusted debt-to-EBITDA ratio of more than 2.75x, including these investments, accompanied by limited prospects to reduce leverage within the next 12 months.

Upside scenario

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.

Standard & Poor's Base-Case Scenario

Assumptions	Key Metrics

Assumptions

- Competitive and regulatory pressures in Austria and Bulgaria and still weak economic conditions in Telekom Austria's service areas are likely to burden group revenues in 2013, before revenues stabilize in 2014.
- Lower revenues and mobile customer investments in Austria will dampen margins, despite some cost cutting.
- Spectrum license costs potentially in excess of €0.3 billion in Austria in 2013.
- €600 million hybrid bond issue in January 2013, including 50% equity credit under our criteria.

Key Metrics

	2012A	2013E	2014E
Comparable EBITDA margin* (%)	33.6	30-32	32-34
Discretionary cash flow§ (bil. €)	0.15	0.25-0.35	0.30-0.40
S&P adjusted debt to EBITDA (x)	2.7	2.9-3.1	2.5-2.7

A--Actual. E--Estimate. *Before restructuring costs and impairments. §Before spectrum investments; defined as cash flow from operations less capital expenditures in tangible and intangible assets and after dividend distributions.

Company Description

Headquartered in Vienna, Telekom Austria is the leading telecom provider in Austria and a leading mobile operator in Bulgaria, Croatia, Belarus, Slovenia, Serbia, Macedonia, and Liechtenstein. As of Dec. 31, 2012, the group had 1.0 million access lines and 1.3 million retail broadband Internet customers in Austria and, in total, 20.9 million mobile subscribers.

As of Dec. 31, 2012, Telekom Austria's largest shareholder was the Republic of Austria, which has an indirect 28.4% stake through its fully-owned state holding company Oesterreichische Industrie Holding AG (OIAG; not rated). In addition, América Móvil directly and indirectly holds 22.8% of Telekom Austria.

Business Risk: Satisfactory

Telekom Austria's business risk profile benefits from the group's established and solid position in the wealthy, but mature and relatively small, Austrian telecom market. The regulators recently approved wireless consolidation to three players from four. We expect the consolidation could support somewhat more favorable market dynamics in Austria in the future. As of year-end 2012, Telekom Austria had relatively high and sustainable market shares for fixed-line broadband Internet (about 60%), mobile telephony (39%), and mobile broadband (36%). Additional support stems from Telekom Austria's market-leading and profitable international mobile operations, which help diversify its revenue base, in our view. The group's largest international operations are its Bulgarian mobile subsidiary Mobiltel (which reported a 47% subscriber market share and 44% EBITDA margin in 2012), Croatia-based Vipnet (38% market share and 33% EBITDA margin), and Belarus-based Velcom (44% market share and 41% EBITDA margin). Furthermore, Telekom Austria has an extensive mobile and fixed-line network infrastructure in Austria, coupled with a strong brand.

Nevertheless, competition among mobile operators is still fierce and very competitively priced mobile broadband products depress prices and subscriber growth in fixed-line broadband Internet services, in our opinion. We also note that the group is exposed to strong regulatory pressure, mainly on mobile-termination and roaming tariffs, which will likely curb prices of mobile telephone services in 2013, in our view. The rigid domestic cost structure also constrains the group's business risk profile. Telekom Austria has a high number of civil servants (53% of domestic employees) in its workforce who cannot be laid off. The group is also exposed to country risk through its international mobile operations, particularly in Belarus. In our opinion, the revenues and earnings of Telekom Austria's international mobile operations are likely to be more volatile than those of its domestic operations.

S&P Base-Case Operating Scenario

Our base-case assessment primarily reflects our expectation that Telekom Austria will continue to face fierce competitive and regulatory pressure in Austria and Bulgaria and still-weak economic conditions in its services areas in 2013. However, we also anticipate more reasonable pricing behavior in the Austrian mobile market, stabilization of ARPU at low levels due to the company's investments in high-value domestic mobile customers in 2013, and improving economic conditions and lessening regulatory pressure on revenues from 2014.

- We expect the group's revenues to decline by about 3%-4% in 2013, following a 2.8% decrease in 2012, with no growth or only a 1% dip in 2014.
- We expect the group's comparable EBITDA margin, as adjusted by Telekom Austria, to contract to about 30%-32% in 2013 from 34% in 2012, but to recover gradually thereafter, partly due to lower mobile market investments.

Peer comparison

Table 1

Telekom Austria AG Peer Comparison

Industry Sector: Telecom

	Telekom Austria AG	Koninklijke KPN N.V.	Telefonica Czech Republic AS	Telekomunikacja Polska S.A.	Elisa Corp.
Rating as of April 18, 2013	BBB/Stable/A-2	BBB-/Stable/A-3	BBB/Negative/--	BBB+/Negative/--	BBB/Stable/A-2
(Mil. €)	**--Fiscal year ended Dec. 31, 2012--**				
Revenues	4,329.7	12,409.0	2,021.8	3,463.8	1,553.4
EBITDA	1,373.1	4,469.9	792.8	1,198.3	512.3
Net income from continuing operations	103.6	691.0	270.0	209.3	208.7
Funds from operations (FFO)	1,209.1	3,559.8	726.0	1,140.6	432.4
Capital expenditures	749.8	3,021.0	261.2	732.9	231.7
Free operating cash flow	315.6	531.8	464.8	(241.9)	151.2
Discretionary cash flow	147.4	(447.2)	112.3	(724.2)	(52.3)
Cash and short-term investments	50.0	250.0	121.3	95.5	0.0
Debt	3,668.8	17,690.8	417.4	1,754.1	924.6
Equity	813.5	1,426.0	2,413.3	3,172.7	844.9

Table 1

Telekom Austria AG Peer Comparison (cont.)					
Adjusted ratios					
EBITDA margin (%)	31.7	36.0	39.2	34.6	33.0
EBITDA interest coverage (x)	7.0	5.2	37.0	12.7	15.3
Return on capital (%)	9.1	10.9	10.8	8.5	17.5
FFO/debt (%)	33.0	20.1	174.0	65.1	46.8
Free operating cash flow/debt (%)	8.6	3.0	112.5	(13.0)	16.3
Debt/EBITDA (x)	2.7	4.0	0.5	1.5	1.8
Total debt/debt plus equity (%)	81.9	92.5	14.7	35.6	52.3

Financial Risk: Intermediate

Telekom Austria's financial risk profile is primarily supported by the group's ability to generate sustainable free operating cash flow (FOCF), albeit at lower levels than in the past due to the company's ongoing restructuring related cash outflows and lower EBITDA generation. In addition, the group demonstrates a transparent and moderately conservative financial policy. The company currently targets a "solid investment-grade rating" with an absolute rating floor of 'BBB', a stable outlook, and a leverage ratio (net debt to comparable EBITDA) of about 2.0x in the medium term. The group significantly cut its dividend per share to €0.05 per share for fiscal 2012 from €0.75 for fiscal 2010 and issued a €600 million hybrid bond in January 2013 to protect its DCF and credit metrics. We assess the hybrid bond as having "intermediate" equity content under our criteria. As a result, we allocate 50% of the related payments on these securities as a fixed-interest charge and 50% as equivalent to a common dividend, in line with our hybrid capital criteria. The 50% treatment (of principal and accrued interest) also applies to our adjustment of debt.

Nevertheless, the group's credit metrics are currently at the aggressive end of our expectations and leave limited headroom for operational underperformance, versus our base case or higher-than-expected spectrum investments in Austria. In addition, we expect the difference between the group's financial policy leverage and Standard & Poor's adjusted leverage to increase to about 0.7x, primarily because of our adjustments for the hybrid bond (which the company reports entirely as equity), restructuring related cash outflows, as well as customary adjustments for unfunded pension obligations, operating leases, and asset retirement obligations. Another financial risk constraint is the group's foreign exchange exposure, primarily due to its international mobile operations in Belarus, Serbia, and Macedonia. Nevertheless, unlike the Belarusian ruble, the exchange rate of the Croatian kuna has been fairly stable against the euro in past years, while the Bulgarian lev is pegged to the euro.

S&P Base-Case Cash Flow And Capital Structure Scenario

In our base-case scenario, we anticipate the group's net debt-to-EBITDA ratio, after our adjustments, could exceed 2.8x at the end of 2013, compared with 2.7x at year-end 2012, primarily due to cash outflows from the acquisition of fourth-generation (4G) spectrum in Austria in the fourth quarter. Nevertheless, we forecast meaningful deleveraging in 2014, primarily as a result of positive DCF and higher EBITDA generation. We assume the following:

- FFO of about €1.1 billion annually.
- Capital expenditures, excluding spectrum investments, of about €0.7 billion in 2013 and 2014 (equaling about 17% of sales), compared with €728 million in 2012.
- Limited dividends of €22 million.

Financial summary

Table 2

Telekom Austria AG Financial Summary

Industry Sector: Telecom					
	--Fiscal year ended Dec. 31--				
(Mil. €)	**2012**	**2011**	**2010**	**2009**	**2008**
Revenues	4,329.7	4,454.6	4,650.8	4,802.0	5,170.3
EBITDA	1,373.1	1,442.5	1,604.3	1,762.0	1,898.2
Net income from continuing operations	103.6	(252.0)	195.4	95.1	(48.8)
Funds from operations (FFO)	1,209.1	1,296.1	1,450.8	1,525.8	1,702.0
Capital expenditures	749.8	760.0	773.8	725.7	840.0
Free operating cash flow	315.6	471.4	641.0	675.9	739.2
Discretionary cash flow	147.4	139.5	309.1	344.1	407.6
Cash and short-term investments	50.0	50.0	56.6	8.8	80.6
Debt	3,668.8	3,761.3	3,761.0	4,061.4	4,416.0
Equity	813.5	875.9	1,470.2	1,620.8	2,167.9
Adjusted ratios					
EBITDA margin (%)	31.7	32.4	34.5	36.7	36.7
EBITDA interest coverage (x)	7.0	7.7	9.1	8.2	8.2
Return on capital (%)	9.1	7.9	9.5	11.0	10.8
FFO/debt (%)	33.0	34.5	38.6	37.6	38.5
Free operating cash flow/debt (%)	8.6	12.5	17.0	16.6	16.7
Debt/EBITDA (x)	2.7	2.6	2.3	2.3	2.3
Debt/debt and equity (%)	81.9	81.1	71.9	71.5	67.1

Liquidity: Adequate

The short-term rating is 'A-2', reflecting the long-term rating of 'BBB' on Telekom Austria and our assessment of the group's liquidity as "adequate" under our criteria.

Under our base case, we calculate that the ratio of liquidity sources to uses will exceed 1.2x in 2013 and 2014.

Principal Liquidity Sources	Principal Liquidity Uses
As of Dec. 31, 2012, liquidity sources mainly comprised: • Surplus cash of about €0.6 billion; • About €1.1 billion available under various committed credit facilities, of which €835 million mature after 2015; • Positive FFO of more than €1.0 billion; and • €0.6 billion proceeds from the hybrid bond issue in January 2013.	As of Dec. 31, 2012, liquidity uses included: • Sizable debt maturities and modest deferred payments related to acquisitions, together totaling about €1.0 billion; • Capital expenditures of about €0.7 billion and moderately negative working capital requirements; • €351 million in cash outflows related to the completed acquisition of certain assets from Orange Austria; • Potentially significant cash outflows related to spectrum investments in Austria; and • Annual shareholder dividends of €22 million.

Debt maturities

As of Dec. 31, 2012:

- 2013: €1,079 million*
- 2014: €137 million
- 2015: €269 million
- 2016: €823 million
- 2017: €566 million
- Thereafter: €1,038 million

*Including accrued interest.

Reconciliation

Table 3

Reconciliation Of Telekom Austria AG Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. €)

	--Fiscal year ended Dec. 31, 2012--						
Telekom Austria AG reported amounts							
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**Cash flow from operations**	**Capital expenditures**
Reported	3,881.4	835.1	1,420.8	456.8	181.8	1,047.9	728.2
Standard & Poor's adjustments							
Operating leases	89.6	--	5.5	5.5	5.5	26.0	23.6
Postretirement benefit obligations	155.7	(22.7)	4.8	4.8	6.3	(6.5)	--
Surplus cash and near cash investments	(635.9)	--	--	--	--	--	--

Table 3

Reconciliation Of Telekom Austria AG Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. €) (cont.)							
Capitalized interest	--	--	--	--	2.0	(2.0)	(2.0)
Share-based compensation expense	--	--	0.0	--	--	--	--
Asset retirement obligations	148.7	--	--	--	--	--	--
Reclassification of nonoperating income (expenses)	--	--	--	17.9	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	143.7	--
Minority interests	--	1.1	--	--	--	--	--
Deferred purchase price payments	29.2	--	--	--	--	--	--
Restructuring activities	--	--	(57.9)	(57.9)	--	--	--
Total adjustments	(212.6)	(21.6)	(47.7)	(29.8)	13.8	161.1	21.6
Standard & Poor's adjusted amounts							
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Capital expenditures**
Adjusted	3,668.8	813.5	1,373.1	427.0	195.5	1,209.1	749.8

Related Criteria And Research

All articles listed below are available on RatingsDirect.

Related criteria

- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- 2008 Corporate Criteria: Ratios And Adjustments, April 15, 2008
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008

Related research

- Telekom Austria AG Proposed Junior Subordinated Hybrid Securities Assigned 'BB+' Issue Rating, Jan. 21, 2013

Business And Financial Risk Matrix

Business Risk	Financial Risk					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly Leveraged
Excellent	AAA/AA+	AA	A	A-	BBB	--
Strong	AA	A	A-	BBB	BB	BB-
Satisfactory	A-	BBB+	BBB	BB+	BB-	B+
Fair	--	BBB-	BB+	BB	BB-	B
Weak	--	--	BB	BB-	B+	B-
Vulnerable	--	--	--	B+	B	B- or below

Note: These rating outcomes are shown for guidance purposes only. The ratings indicated in each cell of the matrix are the midpoints of the likely rating possibilities. There can be small positives and negatives that would lead to an outcome of one notch higher or lower than the typical matrix outcome. Moreover, there will be exceptions that go beyond a one-notch divergence. For example, the matrix does not address the lowest rungs of the credit spectrum (i.e., the 'CCC' category and lower). Other rating outcomes that are more than one notch off the matrix may occur for companies that have liquidity that we judge as "less than adequate" or "weak" under our criteria, or companies with "satisfactory" or better business risk profiles that have extreme debt burdens due to leveraged buyouts or other reasons. For government-related entities (GREs), the indicated rating would apply to the standalone credit profile, before giving any credit for potential government support.

Ratings Detail (As Of April 18, 2013)

Telekom Austria AG	
Corporate Credit Rating	BBB/Stable/A-2
Commercial Paper	
Local Currency	A-2
Junior Subordinated	BB+
Senior Unsecured	BBB
Corporate Credit Ratings History	
30-Mar-2010	BBB/Stable/A-2
11-Dec-2009	BBB+/Watch Neg/A-2
25-Nov-2008	BBB+/Negative/A-2

*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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