

Rating Action: Moody's downgrades Telekom Austria's ratings to Baa2; stable outlook

Global Credit Research - 23 Oct 2013

Madrid, October 23, 2013 -- Moody's Investors Service has today downgraded the long-term issuer and senior unsecured ratings of all debts issued by Telekom Austria AG (Telekom Austria) and its guaranteed finance subsidiary Telekom Finanzmanagement GmbH to Baa2 from Baa1. Concurrently, Moody's has downgraded to Ba1 from Baa3 the junior subordinated rating on Telekom Austria's hybrid instrument. The company's short-term rating of Prime-2 (P-2) is not affected. The outlook on the ratings is stable.

A full list of ratings is provided towards the end of this press release.

The rating action follows Telekom Austria's announced EUR1 billion debt-financed acquisition of mobile spectrum in the recent auction in Austria. Moody's considers that this acquisition will have a material negative effect on the company's financial ratios.

"We are downgrading Telekom Austria's ratings mainly because its recent debt-financed acquisition of mobile spectrum will have a negative impact on the group's credit metrics," says Carlos Winzer, a Moody's Senior Vice President and lead analyst for Telekom Austria. "Although Telekom Austria's mobile business will benefit from the additional spectrum, the debt-financed nature of the acquisition increases the group's financial risk beyond the level of tolerance for the previous rating."

RATINGS RATIONALE

--DOWNGRADE OF LONG-TERM ISSUER AND SENIOR UNSECURED RATINGS TO Baa2--

The rating downgrade reflects the negative financial implications of Telekom Austria's EUR1 billion debt-financed spectrum acquisition. As a result of the acquisition, for which the group paid more than twice the amount Moody's had expected, Telekom Austria's leverage ratio, measured by gross debt/EBITDA, will deteriorate this year to around 3.4x from 2.9x in 2012. This exceeds the maximum level of 3.0x that Moody's had indicated for the previous rating category.

Moreover, Moody's expects that Telekom Austria's operating performance will remain weak, affected by regulation, fierce competition and the adverse macroeconomic conditions in Austria as well as in other countries in which the group operates.

However, despite the negative financial implications of the acquisition, Moody's recognises that the new spectrum acquired provides Telekom Austria with a unique strategic advantage. The company acquired 67% of the 800 MHz spectrum at the September 2013 auction (the first time this spectrum has been offered), as well as substantial spectrum in the 900 MHz and 1800 MHz bands. As a result, Telekom Austria is in a strong position to undertake an efficient roll-out of a 4G network across Austria and will also benefit from better coverage and greater speed for data transmission. This supports the group's business strategy, which focuses on mobile and fixed broadband investments. However, Moody's does not expect the financial benefits from the acquired spectrum to materialise before 2015.

Telekom Austria's Baa2 rating is supported by (1) the group's scale; (2) its position as a strong integrated player in its highly competitive domestic telecommunications market and a geographically diversified leading mobile operator in Austria and the countries in which it operates in eastern Europe; and (3) its continued solid cash flow generation.

Telekom Austria is a government-related issuer (GRI) and its Baa2 rating currently benefits from one notch of uplift as a result of (1) the group being 28.42% government-owned; (2) its moderate level of default dependence; and (3) Moody's moderate support assumptions for the group. Telekom Austria's baseline credit assessment (BCA), a measure of its standalone credit quality, is baa3.

Moody's expects that despite its weak operating performance, Telekom Austria will retain its strong market position in Austria, weathering macroeconomic and competitive pressures in the markets where it operates, and

that management will preserve the group's financial strength within the publicly stated ratio guidance. Moody's expects Telekom Austria's revenue to decline slightly in the short to medium term, broadly offset by the group's ongoing efforts to sustain margins and cash flow. In addition, the rating agency would expect the group to manage its strategic investments, as well as shareholder remuneration, within the financial ratio guidance for the Baa2 rating level.

From a liquidity risk management perspective, Telekom Austria's liquidity profile will become more constrained as Moody's notes that over the next month, the group faces approximately EUR1 billion of spectrum payments. However, Telekom Austria has around EUR625 million of cash and the group's external liquidity sources include around EUR1 billion worth of committed long-term bank facilities. These are unutilised, and can be drawn at any time, not being subject to material adverse change (MAC) clauses or financial covenants.

--DOWNGRADE OF JUNIOR SUBORDINATED RATING ON HYBRID INSTRUMENT TO Ba1--

The Ba1 rating of Telekom Austria's hybrid debt is two notches below the company's senior unsecured rating of Baa2. This rating differential reflects the deeply subordinated nature of the hybrid debt as well as the fact that it (1) is a perpetual instrument; (2) is very deeply subordinated; (3) provides Telekom Austria with the option to defer coupons on a cumulative basis; (4) has no step-up prior to year 10 and none beyond 100 basis points (bps) thereafter; and (5) has a 500 bps step-up upon a change of control, in which event all senior creditors will be repaid first.

RATIONALE FOR STABLE OUTLOOK

The stable rating outlook reflects Moody's expectation that Telekom Austria will gradually improve its future operating performance in an increasingly tough market in which the company will have to continue to weather macroeconomic, regulatory and competitive pressures. The outlook also factors Moody's expectation that management will preserve the company's financial strength within the publicly stated ratio guidance. Although Moody's expects Telekom Austria to suffer single-digit declines in revenues this year and next, this will be broadly offset by the company's ongoing efforts to sustain margins and cash flow.

WHAT COULD CHANGE THE RATING UP/DOWN

The ratings could come under further downward pressure if (1) Telekom Austria's underlying operating performance were to weaken beyond Moody's current expectations as a result of more adverse macroeconomic, regulatory or competitive developments; or (2) the group were to make additional material debt-financed acquisitions and/or increase shareholder remuneration, such that its credit metrics were to deteriorate (reflected in adjusted retained cash flow (RCF)/adjusted gross debt sustainably below 20% and adjusted gross debt/EBITDA sustainably above 3.3x). Negative pressure could also be exerted on the rating if the group's liquidity profile were to weaken further.

In addition, Moody's would most likely no longer apply its GRI methodology to Telekom Austria or incorporate uplift in its final rating if (1) the government were to reduce its stake in the group to below 20%; or (2) the rating agency were to lower its support assumptions for the group. While either one of these factors would likely result in a one-notch downgrade, there is currently no indication that either will occur.

Although not currently expected, Moody's could consider upgrading Telekom Austria's rating if the group's debt protection ratios were to strengthen as a result of improvements in its operational cash flows, assuming no change in the sovereign rating or the levels of government support and default dependence. This would be reflected by, for example, an adjusted RCF/gross adjusted debt ratio trending towards 30% and a gross adjusted debt/EBITDA ratio that is lower than 2.8x on a sustainable basis.

Downgrades:

..Issuer: Telekom Austria AG

.... Issuer Rating, Downgraded to Baa2 from Baa1

....Junior Subordinated Regular Bond/Debenture, Downgraded to Ba1 from Baa3

....Senior Unsecured Medium-Term Note Program, Downgraded to (P)Baa2 from (P)Baa1

..Issuer: Telekom Finanzmanagement GmbH

...Senior Unsecured Medium-Term Note Program, Downgraded to (P)Baa2 from (P)Baa1
...Senior Unsecured Regular Bond/Debenture Jan 29, 2016, Downgraded to Baa2 from Baa1
...Senior Unsecured Regular Bond/Debenture Jan 27, 2017, Downgraded to Baa2 from Baa1
...Senior Unsecured Regular Bond/Debenture Jul 4, 2023, Downgraded to Baa2 from Baa1
...Senior Unsecured Regular Bond/Debenture Apr 4, 2022, Downgraded to Baa2 from Baa1

Outlook Actions:

..Issuer: Telekom Austria AG
...Outlook, Changed To Stable From Negative
..Issuer: Telekom Finanzmanagement GmbH
...Outlook, Changed To Stable From Negative

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was the Global Telecommunications Industry published in December 2010 and Updated Summary Guidance for Notching Bonds, Preferred Stocks and Hybrid Securities of Corporate Issuers published in February 2007. Other methodologies used include the Government-Related Issuers methodology published in July 2010. Please see the Credit Policy page on www.moody.com for a copy of these methodologies.

Headquartered in Vienna, Austria, Telekom Austria is the leading integrated telecommunications provider in Austria, providing 2.3 million fixed access lines, almost 1.3 million fixed-line broadband connections and serving 5.8 million mobile customers (as of 30 June 2013). The group has a nationwide presence, delivering a full range of services and products, including telephony, data exchange, interactive contents, TV and information and communications technology (ICT) solutions. The group has also expanded its mobile operations outside Austria, where its customer base accounts for more than 15.3 million subscribers. Telekom Austria is one of the leading mobile operators in Bulgaria (through its subsidiary MobilTel), Belarus (Velcom) and Croatia (Vipnet), and is also present in Slovenia (si.mobil), Macedonia (Vip operator), Serbia (Vip mobile) and Liechtenstein. Telekom Austria's main shareholders are the Austrian government, with a 28.42% holding, and America Movil, which as of 30 September 2013 held direct and indirect shares in the group amounting to 23.7%. Group revenues amounted to EUR4.3 billion and EBITA to EUR1.4 billion as of December 2012.

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