MOODY'S INVESTORS SERVICE

CREDIT OPINION
8 July 2019

Update

Rate this Research

RATINGS

Telekom Austria AG

Domicile	Vienna, Austria
Long Term Rating	Baa1
Type	LT Issuer Rating
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Telekom Austria AG

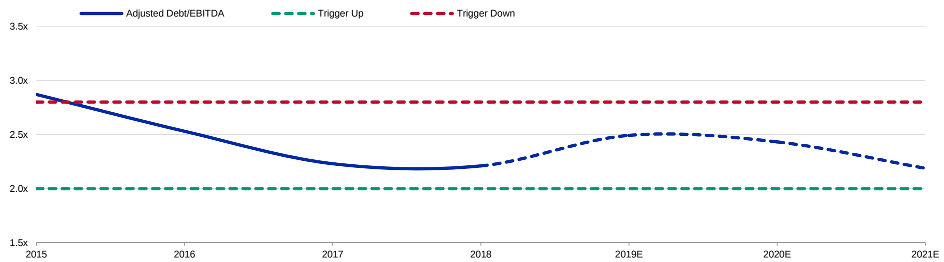
Update to credit analysis: conservative balance sheet

Summary

Telekom Austria AG's (Telekom Austria) Baa1 rating is supported by (1) the group's moderate scale; (2) its position as a strong integrated company in the highly competitive domestic telecommunications market; (3) its geographic diversification in a number of Eastern European countries, mitigated by the fact that these countries are exposed to higher macroeconomic risk and foreign-currency risk in Belarus; (4) its strong cash flow generation and strong credit metrics; (5) the company's public commitment to a conservative financial strategy; and (6) the benefits resulting from America Movil, S.A.B. de C.V.'s (America Movil, A3 stable) shareholding in Telekom Austria.

Telekom Austria is a government-related issuer (GRI) and its Baa1 rating benefits from one notch of uplift as a result of (1) the group being 28.42% owned by the Government of Austria (Aa1 stable), (2) its moderate level of default dependence, and (3) our moderate support assumptions for the group. Telekom Austria's Baseline Credit Assessment (BCA), a measure of its standalone credit quality, is baa2.

Exhibit 1
Gross leverage to reduce to around 2.2x by 2021



Projections include the IFRS 16 impact. Moody's Forecasts are Moody's opinion and do not represent the views of the issuer.
Sources: Moody's Financial Metrics™, Moody's Investors Service

Credit strengths

» Ongoing stabilization in operating performance

» Leading market position in Austria and a number of Central and Eastern European (CEE) countries, although in highly competitive environments

» Continued commitment to an investment-grade rating

» Support from the Government of Austria, which translates into a one-notch uplift to the final rating

» Strong implicit support from America Movil

Credit challenges

» Regulatory and foreign-exchange risks in Belarus

» A very competitive domestic market

» Highly capital-intensive investments as a result of acceleration in fiber rollout, in line with industry average

» Uncertain future investments in spectrum

Rating outlook

The stable outlook reflects our expectation that the group will maintain its improved financial metrics and business positioning in Austria and its international footprint. As a result, we expect Telekom Austria's leverage ratio, measured by adjusted gross debt/EBITDA, to be sustained below 2.5x and retained cash flow (RCF)/debt to be above 30%.

The stable outlook on the rating also reflects our expectation that Telekom Austria will continue to improve its operating performance in a highly competitive market, in which it will continue to benefit from past investments to improve the quality of the network.

The stable outlook takes into account a degree of event risk, which is low, and mitigated by the lack of sizable opportunities in the markets where Telekom Austria operates and the company's conservative financial policies.

Factors that could lead to an upgrade

We 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 flow, assuming no changes in the sovereign rating or levels of government support and default dependence. This improvement would be reflected by its adjusted RCF/gross adjusted debt trending toward 35% and gross adjusted debt/EBITDA remaining lower than 2.0x on a sustained basis.

Factors that could lead to a downgrade

The rating could come under downward pressure if (1) Telekom Austria's underlying operating performance were to weaken as a result of more adverse macroeconomic, regulatory or competitive developments; (2) the group's liquidity profile were to deteriorate; or (3) the group were to make additional material debt-financed acquisitions or increase shareholder remuneration, such that its credit metrics would deteriorate, as reflected by adjusted RCF/adjusted gross debt remaining sustainably below 30% and adjusted gross debt/EBITDA staying sustainably above 2.8x.

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

Key indicators

Exhibit 2
Telekom Austria AG [1]

Telekom Austria AG

EUR Millions	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	LTM (Mar-19)	2019-proj	2020-proj
Revenue	4,018	4,020	4,125	4,280	4,343	4,359	4,410.9	4,487
Debt / EBITDA	3.1x	2.9x	2.5x	2.2x	2.2x	2.5x	2.5x	2.4x
RCF / Debt	27.9%	25.8%	30.9%	32.3%	34.1%	31.1%	31.6%	32.6%
(EBITDA - CAPEX) / Interest Expens	2.7x	3.2x	3.2x	5.6x	5.7x	5.2x	4.9x	4.9x
Net Debt / EBITDA	2.4x	2.3x	2.2x	2.1x	2.2x	2.5x	2.5x	2.4x
RCF / Net Debt	36.0%	32.5%	35.2%	34.3%	34.7%	31.6%	32.1%	33.1%

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Moody's Forecasts are Moody's opinion and do not represent the views of the issuer.
Source: Moody's Financial Metrics™

Profile

Headquartered in Vienna, Austria, Telekom Austria AG (Telekom Austria) is the leading integrated telecommunications provider in the country, providing 2 million fixed access lines and almost 1.5 million broadband connections, and serving 5.3 million mobile customers (as of 31 March 2019). The group has a nationwide presence, delivering a full range of services and products, including telephony, data exchange, interactive content, TV, and information and communications technology solutions. The group has also expanded its mobile operations outside Austria, where its customer base accounts for more than 14.5 million subscribers (excluding machine-to-machine subscribers). Telekom Austria is one of the leading mobile operators in Bulgaria, through its subsidiary A1 Bulgaria EAD, Belarus (Velcom) and Croatia (A1 Croatia), and is also present in Slovenia (A1 Slovenija d.d.), Macedonia (One.Vip DOOEL), Serbia (Vip Mobile d.o.o) and Liechtenstein (Telecom Lichtenstein AG).

Telekom Austria's main shareholders are America Movil, with a 51% holding (fully consolidating Telekom Austria), and the Austrian government, with a 28.42% holding. In 2018, group revenue totaled €4.47 billion and EBITDA €1.38 billion.

Detailed credit considerations

Credit metrics have improved and will remain at the current strong levels without sizable debt-financed M&A

Management continues to implement a number of actions to enhance its financial flexibility, including (1) accelerated cost-cutting initiatives; (2) a moderate shareholder remuneration policy; and (3) a conservative capital structure with a moderate leverage.

America Movil, as Telekom Austria's major shareholder with a 51% stake, is instrumental in this process. As part of the shareholder agreement, Telekom Austria successfully completed a capital increase in November 2014 that amounted to €1 billion. This improved Telekom Austria's capital structure and financial position, and provided additional financial flexibility for investments.

America Movil has also had a positive impact on Telekom Austria's overall strategic execution, broadly because of (1) the possibility of the Austrian operator leveraging the size of its main shareholder to gain substantial purchasing power with vendors or to enhance relationships with financial institutions, (2) the shift from a marketing to a sales-oriented approach, and (3) the strong focus on the business and cost savings.

Leverage, measured by gross adjusted debt/EBITDA, declined steadily to 2.5x as of March 2019 (including the IFRS 16 impact) from the peak of 3.5x in 2013. We expect leverage to remain broadly stable over the next 24 months, remaining at around 2.5x and 2.4x in 2019 and 2020, respectively.

Telekom Austria has strong credit metrics, which will likely improve without sizable debt-financed M&A.

The group is likely to focus its M&A activity on small acquisitions to strengthen its market position. Examples of small acquisitions include the past acquisition of Metronet in Croatia, which enhanced its position in the country's business-to-business market, and the acquisition of Gomelsky OTTC Garant in Belarus, which contributed to improving the group's convergent position in the country.

The company has stated that any transaction will be funded within the tolerance levels of the investment-grade rating category. However, we do not expect any significant transaction to take place in the next 12-24 months.

Leading market position, although in a competitive environment

Telekom Austria holds a stable, leading position in the domestic mobile market, with a reported market share of 60.5% (of voice minutes) as of December 2018. As of March 2019, the group also reported a market share of 55.1% in fixed broadband.

In 2018, T-Mobile Austria (a subsidiary of Deutsche Telekom AG [Baa1 negative]) acquired UPC Austria for an enterprise value of €1.9 billion. This transaction allowed Deutsche Telekom AG to become a fully convergent company in the Austrian market, potentially exerting pressure on Telekom Austria's operational performance. However, we note that Telekom Austria launched its bundled tariffs in Austria in 2018 to mitigate the competitive pressure.

We expect both mobile and fixed-line markets to remain competitive in 2019. However, we note significant improvements in Austria following ongoing price increases carried out by the three main operators. In the premium segment, operators are likely to focus on customer upselling strategies rather than on promotions to gain market share. Nevertheless, we do not expect the Austrian market to experience a significant price increase in the next two years.

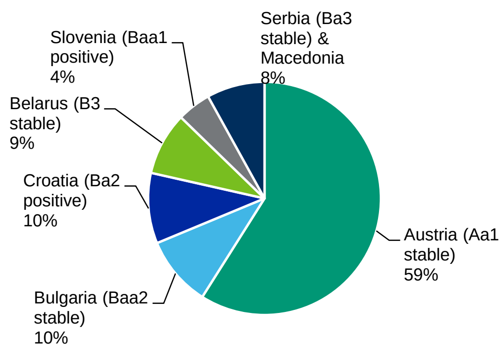
As of March 2019, Telekom Austria was also one of the leading mobile operators in Bulgaria (around 40% reported market share), Croatia (around 36%) and Belarus (around 42%). In 2018, the group showed strong performance in the CEE markets, driven by service revenue growth in all segments (excluding foreign-exchange effects in Belarus) except Slovenia, where fierce competition continues to impose challenges, although it represents a small portion of Telekom Austria's revenue (4% as of 2018).

In our view, the positive aspects of Telekom Austria's diversification in a number of Eastern European countries are somewhat mitigated by the exposure to higher macroeconomic and foreign-currency risks. Moreover, as Exhibit 4 shows, the highly capital-intensive nature of these markets implies that cash flow generation (measured as EBITDA - capital spending) is substantially below that in the domestic market, where 65% of operating cash flow was generated in 2018. We expect this figure to fall below 60% by 2019-20 in light of the top-line growth potential of the international units.

Exhibit 3

Austria represented 59% of revenue

2018 External Revenue by geography

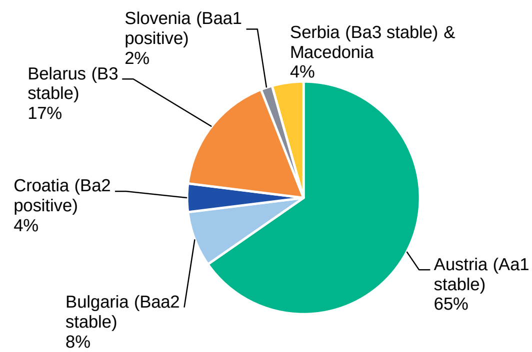


[1] Corporate, other and eliminations excluded from the calculation
Source: Company Data

Exhibit 4

Austria represented 65% of operating free cash flow in 2018

2018 operating free cash flow breakdown by geography



[1] Corporate, other and eliminations excluded from the calculation
[2] Operating free cash flow calculated as EBITDA- capital spending (inclusive of spectrum payments)
Source: Company Data

High capital spending for investments in fiber and 4G leads to strategic advantage over competitors

The group's key areas of investment include the expansion of its LTE mobile network across its markets and the acceleration of the fiber rollout in Austria.

Telekom Austria will continue to adapt its fixed network infrastructure to meet the growing demand for high-bandwidth broadband solutions. As of FY 2018, 75% of Telekom Austria's customers had access to products with a bandwidth lower than 40 Mbps, which implies a significant upselling potential. However, through the introduction of the hybrid modem — a technology that combines fixed-line and mobile networks to increase bandwidth — current household coverage for a 100 Mbps speed is already available to around 50% of Telekom Austria customers. This technological development will be key in (1) meeting the increasing demand for high-bandwidth speeds through the current fixed and mobile networks, (2) maintaining a competitive edge with cable operators, and (3) upselling current ADSL products.

We expect Telekom Austria's capital spending (excluding spectrum) to remain high at 17%-19% over sales (€800 million-€825 million per year) over the next two years. Capital spending will be the principal use of its cash flow generation, given the expected moderate dividend policy and lack of sizable M&A opportunities.

In addition, we expect additional cash outflows in 2020 in relation to spectrum auction payments in Austria for the 3.4-3.8 gigahertz (GHz) bands and for the 700 megahertz (MHz), 1,500 MHz and 2,100 MHz bands.

Solid operating performance, driven by international markets, despite modest improvements in the domestic market

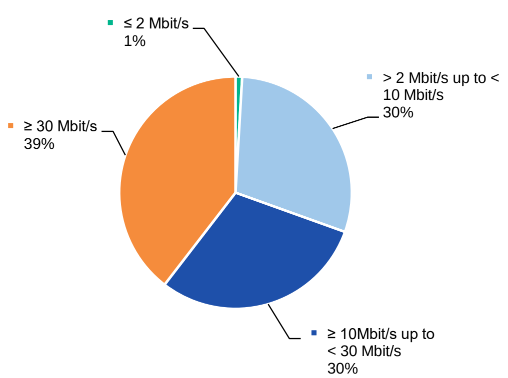
We expect the group's operating performance in the Austrian market to slightly improve over the next three years in light of lower competition in mobile, lower impact from roaming and a positive evolution of the fixed broadband segment over the medium term. We expect these factors to offset continued fixed-voice losses.

The acceleration in fiber rollout may support growth in the country as customers on low-priced data plans may revert to fixed broadband. In line with other European countries, the lack of high-speed fixed broadband infrastructure in Austria has been a key catalyst in the expansion of mobile broadband, which is cheaper than fiber and capable of delivering comparable speeds. As Exhibit 5 shows, as of December 2018, a significant part of fixed broadband connections (30%) had a bandwidth of 2-10 Mbps. Fiber rollout is also likely to boost the overall low degree of convergence in the country, with Telekom Austria expected to be the main beneficiary.

Exhibit 5

Most of Austrian fixed broadband connections have bandwidths below 30 Mbps

Fixed broadband breakdown by bandwidth as of December 2018

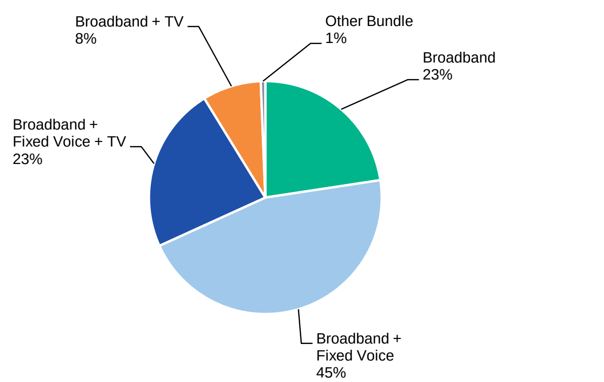


Source: Rundfunk Und Telekom Regulierungs

Exhibit 6

Telekom Austria is likely to be the main beneficiary of the potential increase in convergence in the Austrian market

Consumer broadband connections by bundle category as of December 2018



Source: Rundfunk Und Telekom Regulierungs

Despite the expected slight revenue growth in the Austrian market, we expect the group's international operations to be its growth driver. We expect revenue to grow annually between 1% and 2% over the next three years, with growth in the international units compensating for slower growth in the domestic market. The company's EBITDA is likely to be affected by restructuring charges in 2019, with improvements to be seen in 2020, driven by efficiencies arising from cost cutting.

Liquidity analysis

As of March 2019, Telekom Austria had around €53.3 million of cash and cash equivalents. In addition, the group has a €1 billion committed syndicated credit line and €215 million of bilateral credit facilities. These facilities are not subject to material adverse change clauses or financial covenants.

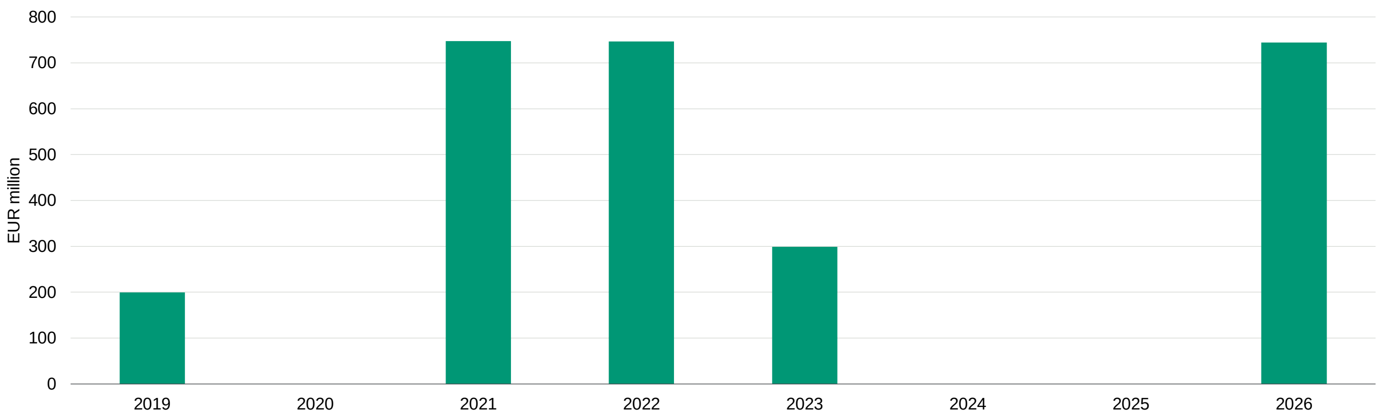
Telekom Austria's liquidity profile is sufficient to cover its upcoming debt maturities, as well as other cash demands. In this regard, we expect free cash flow generation (after capital spending and dividends, and before spectrum payments) to be around €200 million over the next 12-24 months. The group's average cost of debt is around 2.73%, with an average term to maturity of 4.12 years as of the end of March 2019.

Upcoming debt maturities include two €750 million bonds maturing in December 2021 and April 2022.

Exhibit 7

Next bond maturity will take place in December 2021

Telekom Austria's debt maturity profile as of March 2019



Source: Company data

Rating methodology and scorecard factors

Rating methodology grid

The Baa2 outcome from the Telecommunications Service Providers rating methodology grid is in line with the underlying BCA (baa2) of Telekom Austria. The final rating of Baa1 benefits from one notch of uplift because of government support.

We expect Telekom Austria's credit metrics to improve slightly over 2019-20. Over the same period, we expect revenue to grow 1.0%-2.0% per year, because of growth coming from the CEE countries and slightly improved performance in Austria. We expect adjusted RCF/debt to be in the 32%-33% range and (EBITDA - capital spending)/gross interest expense to be around 5.0x. In terms of leverage, debt/EBITDA is likely to remain at around 2.5x-2.3x for the next 12-18 months.

Exhibit 8
Rating methodology
Telekom Austria AG

Methodology: Telecommunications Service Providers	Current LTM (Mar-19)		Moody's Forward View Next 12-18 months (as of Jul-19)	
Factor 1: SCALE (12%)	Measure	Score	Measure	Score
a) Revenue (USD Billion)	$5	Ba	$5	Ba
Factor 2: BUSINESS PROFILE (28%)				
a) Business Model, Competitive Environment and Technical Positioning	A	A	A	A
b) Regulatory Environment	Ba	Ba	Ba	Ba
c) Market Share	Baa	Baa	Baa	Baa
Factor 3: PROFITABILITY AND EFFICIENCY (10%)				
a) Revenue Trend and Margin Sustainability	Baa	Baa	Baa	Baa
Factor 4: LEVERAGE AND COVERAGE (35%)				
a) Debt / EBITDA	2.5x	Baa	2.5x-2.3x	Baa
b) RCF / Debt	31.1%	Baa	32%-33%	Baa
c) (EBITDA - CAPEX) / Interest Expense	5.2x	A	5.0x	A
Factor 5: FINANCIAL POLICY (15%)				
a) Financial Policy	Baa	Baa	Baa	Baa
Rating Outcome:				
a) Scorecard Indicated Outcome				Baa2
b) Actual Rating Asigned				Baa1
Government-Related Issuer	**Factor**			
a) Baseline Credit Assessment	baa2			
b) Government Local Currency Rating	Aa1			
c) Default Dependence	Moderate			
d) Support	Moderate			
e) Final Rating Outcome	Baa1			

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] This represents Moody's forward view, not the view of the issuer, and unless noted in the text, does not incorporate significant acquisitions and divestitures.
Sources: Moody's Financial Metrics™, Moody's Investors Service

GRI considerations

Given Telekom Austria is 28.42% owned by the Austrian government, the group is considered a GRI under our methodology. Therefore, we consider the following inputs:

(1) A BCA of baa2, reflecting Telekom Austria's underlying credit strength

(2) The local-currency rating of Austria

(3) The moderate default dependence, reflecting the financial and operational links between the group and the Austrian economy

(4) We have factored into Telekom Austria's rating a moderate level of government support based on the following considerations: (1) there is no explicit expression of support by the government (that is, the government does not guarantee the debt of the GRI); (2) the government's 28.42% ownership of Telekom Austria and its willingness to behave as a rational shareholder might suggest that the government would be unlikely to be the sole provider of support — instead, it would only consider providing support jointly with other shareholders in the form of a capital increase; (3) there are European Union policy barriers to the provision of direct financial support and

the government is likely to obey these rules; (4) we consider the Austrian government's historical approach moderately interventionist — the government reviews and supervises Telekom Austria's business and funding plans, which we consider positive relative to support assumptions, and appoints a number of board members; (5) in our view, it is unlikely that the Austrian government's reputation would be damaged in the event of a default by Telekom Austria; and (6) given its large workforce, the group's level of economic and social importance to Austria appears to be high.

Ratings

Exhibit 9

Category	Moody's Rating
TELEKOM AUSTRIA AG	
Outlook	Stable
Issuer Rating	Baa1
Senior Unsecured MTN -Dom Curr	(P)Baa1
Other Short Term -Dom Curr	(P)P-2
TELEKOM FINANZMANAGEMENT GMBH	
Outlook	Stable
Bkd Senior Unsecured -Dom Curr	Baa1
Bkd Other Short Term -Dom Curr	(P)P-2

Source: Moody's Investors Service

Appendix

Exhibit 10

Peer comparison

	Telekom Austria AG			Deutsche Telekom AG			Swisscom AG			Elisa Corporation			Telia Company AB		
	(P)Baa1 Stable			Baa1 Negative			A2 Stable			Baa2 Stable			Baa1 Stable		
(in US millions)	FYE Dec-16	FYE Dec-17	FYE Dec-18	FYE Dec-16	FYE Dec-17	FYE Dec-18	FYE Dec-16	FYE Dec-17	FYE Dec-18	FYE Dec-16	FYE Dec-17	FYE Dec-18	FYE Dec-16	FYE Dec-17	FYE Dec-18
Revenues	$4,564	$4,836	$5,129	$80,877	$84,680	$89,343	$11,821	$11,850	$11,976	$1,810	$2,020	$2,163	$9,846	$9,353	$9,624
EBITDA	$1,683	$1,748	$1,826	$26,156	$28,690	$30,008	$4,485	$4,445	$4,488	$688	$749	$817	$3,235	$3,096	$3,188
Total Debt	$4,058	$4,145	$3,914	$87,238	$92,856	$95,817	$11,110	$10,700	$10,777	$1,458	$1,581	$1,565	$12,640	$11,280	$10,792
Cash & Cash Equivalents	$490	$243	$73	$8,163	$3,967	$4,192	$324	$539	$481	$47	$53	$92	$3,140	$4,213	$2,543
EBITDA Margin	36.9%	36.1%	35.6%	32.3%	33.9%	33.6%	37.9%	37.5%	37.5%	38.0%	37.1%	37.8%	32.9%	33.1%	33.1%
(EBITDA-CAPEX) / Interest Expense	3.2x	5.6x	5.7x	2.7x	3.0x	3.1x	6.7x	7.7x	8.5x	12.4x	12.7x	12.9x	2.8x	2.6x	4.5x
Debt / EBITDA	2.5x	2.2x	2.2x	3.5x	3.0x	3.3x	2.6x	2.4x	2.4x	2.2x	2.0x	2.0x	4.2x	3.5x	3.5x
FCF / Debt	3.8%	5.9%	6.1%	3.6%	4.6%	6.1%	1.4%	5.4%	2.3%	4.0%	0.5%	1.2%	-6.5%	-2.1%	3.3%
RCF / Debt	30.9%	32.3%	34.1%	22.8%	27.3%	26.3%	24.7%	27.7%	26.2%	22.3%	25.2%	23.4%	10.6%	21.5%	16.4%

All figures and ratios calculated using Moody's estimates and standard adjustments.
Source: Moody's Financial Metrics™

Exhibit 11

Operating lease represents more than 14% of Moody's-adjusted debt
Telekom Austria's Moody's-adjusted debt breakdown

(in EUR Thousands)	FYE Dec-15	FYE Dec-16	FYE Dec-17	FYE Dec-18
As Reported Debt	**3,394,562**	**2,803,561**	**2,534,173**	**2,782,048**
Pensions	127,372	141,028	136,117	143,678
Operating Leases	509,229	495,954	486,078	496,740
Hybrid Securities	295,593	295,593	295,593	-
Non-Standard Adjustments	100,149	111,667	19	1,271
Moody's-Adjusted Debt	**4,426,905**	**3,847,803**	**3,451,980**	**3,423,737**

Source: Moody's Financial Metrics™

Exhibit 12

Historical EBITDA adjustment breakdown

Telekom Austria's Moody's-adjusted EBITDA breakdown

(in EUR Thousands)	FYE Dec-15	FYE Dec-16	FYE Dec-17	FYE Dec-18
As Reported EBITDA	**1,380,367**	**1,361,820**	**1,391,967**	**1,389,111**
Pensions	-5,736	-5,209	-5,230	-4,517
Operating Leases	169,743	165,318	162,026	165,580
Interest Expense – Discounting	-	-	-4,720	-4,465
Unusual	-	-3,931	-32	-
Non-Standard Adjustments	-240	2,767	2,674	797
Moody's-Adjusted EBITDA	**1,544,134**	**1,520,765**	**1,546,685**	**1,546,506**

Source: Moody's Financial Metrics™

Exhibit 13

Telekom Austria

Select historical Moody's-adjusted financial data

EUR (millions)	2013	2014	2015	2016	2017	2018	2019-proj	2020-rpoj
INCOME STATEMENT								
Revenue	4,183.9	4,018.0	4,020.3	4,124.8	4,279.7	4,343.5	4,410.0	4,486.6
EBITDA	1,349.4	1,460.2	1,544.1	1,520.8	1,546.7	1,546.5	1507.3	1534.4
BALANCE SHEET								
Cash & Cash Equivalents	203.1	1,019.1	911.5	464.2	202.4	63.6	63.6	63.6
Total Debt	4,753.3	4,557.4	4,426.9	3,847.8	3,452.0	3,423.7	3756.4	3731.3
CASH FLOW								
Capex = Capital Expenditures	1,821.3	895.4	869.5	962.2	844.2	914.6	943.2	968.2
Dividends	10.6	43.3	54.5	54.6	154.2	166.2	133	143.6
Retained Cash Flow	1,157.3	1,272.4	1,143.5	1,189.3	1,113.7	1,166.8	1,187.0	1,214.9
RCF / Debt	24.3%	27.9%	25.8%	30.9%	32.3%	34.1%	31.6%	32.6%
Free Cash Flow (FCF)	-749.7	88.0	275.1	147.0	202.7	210.1	194.3	225.1
FCF / Debt	-15.8%	1.9%	6.2%	3.8%	5.9%	6.1%	5.2%	6.0%
PROFITABILITY								
EBITDA Margin %	32.3%	36.3%	38.4%	36.9%	36.1%	35.6%	34.2%	34.2%
INTEREST COVERAGE								
(EBITDA - CAPEX) / Interest Expense	-2.3x	2.6x	3.2x	3.2x	5.6x	5.7x	4.8x	4.9x
LEVERAGE								
Debt / EBITDA	3.5x	3.1x	2.9x	2.5x	2.2x	2.2x	2.5x	2.4x

Moody's Forecasts are Moody's opinion and do not represent the views of the issuer.
Source: Moody's Financial Metrics™

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