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## Summary:

# Telekom Austria AG

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## Summary:

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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 its "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 (AA+/Negative/A-1+). 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 pressure 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.

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 2.0x-2.5x. The company also aims to maintain an investment-grade rating of 'BBB' and a stable outlook. In December 2011, the group announced plans to cut dividends for 2011-2012 by 50% to protect discretionary cash flow (DCF; cash flow from operations after capital expenditures and dividends) and credit metrics in the face of an unfavorable economic outlook in the group's main markets and potential significant investments in spectrum. At the same time, Telekom Austria faces notable foreign exchange exposure from its international operations in Belarus, Serbia, and the Macedonia, which could reduce its cash flow generation.

### S&P base-case operating scenario

In our base-case assessment, we expect group revenues to decline by about 4% in 2011 and about 2% in 2012, and the EBITDA margin, as adjusted by Telekom Austria, to deteriorate slightly in 2012 from about 34.2% in the 12 months ended Sept. 30, 2011. This primarily reflects our assumption that economic conditions will deteriorate in the company's service areas in 2012 compared with 2011. It also reflects continued fierce competitive and regulatory pressure on revenues, and increasing fixed mobile substitution in Austria. In addition, after a likely sharp revenue drop of more than 20% for 2011, we forecast that euro-denominated revenues at the group's Belarusian mobile operations will decline further in 2012. This stems from our assumption that the Belarusian ruble (BYR) will continue to deteriorate against the euro. In the second half of 2011, the exchange rate depreciated to more than BYR12,000 per €1, from about BYR4,000 at year-end 2010. In our view, these pressures on group revenues will be only partly offset by higher revenues in Telekom Austria's mobile operations in Serbia, Slovenia, and Macedonia, and the consolidation of two Bulgarian fixed-line operators in February 2011 and the largest Croatian cable operator B.net in August 2011. Furthermore, we expect the group's continued cost-cutting efforts to only partly offset the likely revenue erosion.

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

In our base-case assessment, we forecast DCF of about €0.3 billion in 2012, up from €91 million in the 12 months ended Sept. 30, 2011. This is primarily due to the announced dividend cut and lower working capital needs, which we expect to more than offset the likely moderate decline in EBITDA. In addition, our forecast assumes relatively stable capital expenditures of about €750 million in 2011 and 2012. Consequently, we expect the group's net debt-to-EBITDA ratio, after our adjustments, to improve slightly to about 2.5x by year-end 2012, from 2.6x (2.3x as adjusted by Telekom Austria) as of Sept. 30, 2011. Nevertheless, this forecast excludes any spectrum investments or further acquisitions. In turn, the group's adjusted leverage could increase to more than 2.6x in 2012, and DCF could be materially lower than €0.3 billion, depending on the amount and timing of any spectrum investments or acquisitions.

## Liquidity

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

In our base case, we estimate Telekom Austria's liquidity sources in 2012 at about €2.5 billion. These include primarily:

- Surplus cash in excess of €0.5 billion. We consider a large part of the group's available cash and short-term investments as surplus cash, assuming only €50 million in cash is required for operations. We assume that the group continues to be able to repatriate cash from Belarus to Austria, which was, however, not the case for a few months in mid-2011. As of Sept. 30, 2011, the group's cash balances and available short-term investments stood at €478 million.
- About €0.8 billion available under various committed credit facilities, maturing after 2012.
- Positive funds from operations exceeding €1.1 billion.

We estimate the group's liquidity needs in 2012 to be about €2.0 billion, primarily including:

- Significant debt maturities and modest deferred considerations related to acquisitions, together totaling about €1.0 billion. Furthermore, the group faces debt maturities of €947 million in 2013.
- Capital expenditures of about €0.75 billion. This, however, excludes any spectrum investments or acquisitions.
- Annual shareholder dividends of €168 million.

## Outlook

The stable outlook reflects our belief that, despite the likely continuation of strong competitive and regulatory pressures in its main markets, Telekom Austria should be able to generate positive DCF of about €0.3 billion and keep its net debt to comparable EBITDA at the lower end of its 2.0x-2.5x target range. In addition, we believe the group will defend its solid domestic and nondomestic market positions and proactively address its large upcoming debt maturities in 2012 and 2013.

Pressure on the rating could build if the group's operating performance or credit metrics were to deteriorate below our current base-case forecast. This would likely be the case if EBITDA were to decline by about 15% over the next 24 months or if DCF were to turn 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 leverage ratio at the upper end of the group's target range, accompanied by limited prospects to reduce leverage.

We would consider an upgrade if we believed the group could stabilize revenues and moderately improve its current EBITDA margin of 34%. Nevertheless, a positive rating action would 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, unless otherwise stated.

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Principles Of Credit Ratings, Feb. 16, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Key Credit Factors: Business And Financial Risks In The Global Telecommunication, Cable, And Satellite Broadcast Industry, Jan. 27, 2009

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