

## Telekom Austria Affirmed At 'BBB/A-2'; Outlook Stable

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- Austrian telecom operator Telekom Austria reduced leverage in 2015, and we view its credit metrics as increasingly solid for the current rating.
- However, we think these credit metrics may not be sustainable over the medium term, due to Telekom Austria's appetite for mergers and acquisitions and lack of defined leverage targets.
- We are therefore affirming our ratings on Telekom Austria at 'BBB/A-2'.
- The stable outlook reflects our view that, although we expect the company to pursue further acquisitions, adjusted debt to EBITDA will remain below 3.25x and funds from operations to debt above 25% on a sustainable basis.

FRANKFURT (S&P Global Ratings) May 25, 2016--S&P Global Ratings today affirmed its long- and short-term corporate credit ratings on Austrian telecommunications network operator Telekom Austria AG at 'BBB/A-2'. The outlook is stable.

At the same time, we assigned our 'BBB/A-2' long- and short-term corporate credit ratings to Telekom Austria's fully owned finance subsidiary Telekom Finanzmanagement GmbH. The outlook is stable.

We also affirmed our 'BBB' issue ratings on the group's senior unsecured debt, our 'BB+' issue rating on its hybrid debt, and our 'A-2' rating on its commercial paper.

The affirmation reflects our view that although Telekom Austria's credit metrics have been strengthening gradually, we assess this may not be sustainable over the medium term. This is primarily due to the company's appetite for mergers and acquisitions (M&A) and lack of a financial policy

that imposes sufficiently tight limits on incremental debt-funded acquisitions. In 2015, solid EBITDA growth enabled Telekom Austria to improve its S&P Global Ratings-adjusted debt-to-EBITDA ratio to about 2.7x from 2.9x in 2014, and we forecast additional organic deleveraging by about 0.2x in 2017. However, we think that Telekom Austria remains determined to pursue further acquisitions to consolidate its operations within the current footprint, but prospectively also as a means to expand opportunistically into new markets. In combination with a financial policy that defines a 'BBB' rating target, but sets no quantitative caps on leverage, we think its debt-to-EBITFA ratio could rise back to or moderately above 3x in case of larger transactions.

A key factor in our assessment of Telekom Austria's business risk is the company's leading position in fixed and mobile telecommunications markets in Austria, which is supported by almost nationwide coverage with fourth-generation mobile networks, progress with upgrading to higher fixed broadband speeds, and comfortable spectrum holdings. In addition, Telekom Austria is a major player in six Central and Eastern European (CEE) mobile markets where it holds mostly No. 1 or No. 2 positions, and it has enhanced its ability to make fixed-mobile convergence offers with the acquisitions of additional fixed-line operations in Bulgaria, Slovenia, and Croatia in 2015. Nevertheless, Telekom Austria is exposed to fresh competition in the domestic mobile market after the market entry of several mobile virtual network operators (MVNOs). We think this is likely to act as a constraint on pricing and require high levels of handset subsidies for an extended period of time. Equally, Telekom Austria's foreign mobile operations continue to face fierce competition in many markets, in particular in Bulgaria and Slovenia, and its subsidiary in Belarus remains subject to high country and foreign exchange risks. We also expect that the phasing out of retail roaming charges will have an adverse effect on EBITDA of up to €45 million in 2016 and up to an additional €25 million in 2017.

In addition to our evaluation of the company's financial policy, our view of Telekom Austria's financial risk is based primarily on our base-case forecast of debt to EBITDA between 2.4x-2.8x over the next 24 months. Although we expect free operating cash flow (FOCF) generation will improve gradually from 2017, we note that it remains burdened in the near to medium term by cash outflows for restructuring and increasing non-spectrum-related network investments.

The rating is constrained by our view that Telekom Austria's financial policy may not sufficiently limit the build-up of additional debt in the event of material M&A, creating a risk that leverage may deviate meaningfully from our base-case forecast.

The 'BBB' rating benefits from our view of Telekom Austria's strategic importance to América Móvil S.A.B. de C.V. (AMX) since it acquired a controlling stake. Our assessment of Telekom Austria's group status primarily reflects our view that Telekom Austria is unlikely to be sold over the medium term. We understand that AMX intends to use Telekom Austria as a vehicle for

expansion in Europe, particularly in CEE. Therefore, we anticipate that Telekom Austria will be important to the group's long-term strategy and that AMX is likely to support it if it should fall into financial difficulty.

We view Telekom Finanzmanagement GmbH as a core subsidiary of Telekom Austria AG, as this entity serves the sole purpose of raising financing for the group, is fully owned by Telekom Austria, and shares the same corporate name.

We continue to regard Telekom Austria as a government-related entity. Our 'BBB' rating on Telekom Austria, including group support, is not enhanced further for potential government support, as we see a low likelihood of timely and sufficient extraordinary support in the event of financial distress from the group's 28.4% shareholder, the Republic of Austria (AA+/Stable/A-1+).

We assess Telekom Austria's liquidity as strong, based on our expectation that the ratio of liquidity sources to uses will be about 1.5x in the 12 months from April 1, 2016. In addition, we assess Telekom Austria's financial risk management as prudent, and we think that the company has well-established, solid relationships with its banks.

The stable outlook reflects our view that Telekom Austria will continue to pursue M&A opportunities and that potential transactions may weaken its credit metrics relative to our forecast. We expect Telekom Austria will report modest revenue growth of about or slightly below 1% over the next two years, and that its adjusted EBITDA margins will stabilize in 2017 at levels similar to 2015, as successful on-going cost management in Austria and stabilization in Telekom Austria's international markets offsets the adverse EBITDA impact from the phase-out of retail roaming. On this basis, we think that, after accounting for potential additional debt incurred for acquisitions, Telekom Austria will maintain adjusted debt to EBITDA of less than 3.25x and FFO to debt of more than 25% on a sustainable basis.

We could raise the rating if Telekom Austria were to adopt a financial policy that targets adjusted debt to EBITDA of sustainably less than 2.75x and FFO to debt of more than 30% at all times, including in case of acquisitions. Additionally, we could also raise the rating if we see further stabilization of operating trends in Austria and across its foreign subsidiaries, along with stable or increasing adjusted EBITDA margins, supporting FOCF to debt comfortably between 10%-15%.

We could also raise the rating on Telekom Austria if we viewed its strategic importance to its majority shareholder, AMX, as strengthening. This could happen if we were to witness more implicit support from AMX, for example, if AMX were to guarantee Telekom Austria's debt or AMX were to refinance Telekom Austria debt at the parent level.

Although not expected at this stage, we could consider a downgrade if we were to observe a combination of large debt-funded acquisitions and revenues and EBITDA underperforming our projections materially, for example due to continued or rising competitive pressure in Telekom Austria's domestic or

international operations, causing leverage to rise to more than 3.25x and FFO to debt to fall to less than 25% on a prolonged basis.

The ratings on Telekom Austria could also come under pressure if we assessed that Telekom Austria's strategic importance to AMX had weakened, for example, if Telekom Austria appeared likely to be sold over the near term, a scenario which we currently consider unlikely.

#### RELATED CRITERIA AND RESEARCH

##### Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Telecommunications And Cable Industry, June 22, 2014
- Methodology: Industry Risk, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Methodology And Assumptions: Assigning Equity Content To Corporate Entity And North American Insurance Holding Company Hybrid Capital Instruments, April 1, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Criteria Clarification On Hybrid Capital Step-Ups, Call Options, And Replacement Provisions, Oct. 22, 2012
- Hybrid Capital Issue Features: Update On Dividend Stoppers, Look-Backs, And Pushers, Feb. 10, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

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