

Research Update:

Telekom Austria AG 'BBB+/A-2 Ratings Affirmed; Outlook Stable

April 10, 2020

Rating Action Overview

- We have recently lowered our ratings on Telekom Austria's 51% shareholder, America Movil S.A.B. de C.V. (AMX; BBB+/Negative/--).
- At the same time, we have reassessed our view of Telekom Austria AG's position and relationship with the AMX group, and determined that a somewhat lower rating on the latter is unlikely to affect the former.
- We forecast resilient operating performance despite the current COVID-19 pandemic and expect some credit improvements into 2020, supported by management's prudent policy.
- We are therefore affirming our 'BBB+' long-term and 'A-2' short-term issuer credit ratings on Telekom Austria.
- The stable outlook reflects our view that S&P Global Ratings-adjusted debt to EBITDA, funds from operations (FFO) to debt, and free operating cash flow (FOCF; excluding spectrum investments) to debt will be sustained at comfortably below 2.5x, more than 35%, and about 15%.

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Rating Action Rationale

Telekom Austria's credit metrics are somewhat better than forecast, and we continue to view management's financial policy as prudent and supportive. S&P Global Ratings-adjusted metrics were somewhat stronger in 2019 than we previously forecast, due to higher EBITDA and lower debt. Debt to EBITDA and FFO to debt were under 2.5x and over 35%, respectively, and we expect both ratios to gain further headroom within the current rating. We also expect FOCF to debt to remain at about 15%, before spectrum payments, and believe management will seek further deleveraging, which should bring metrics more comfortably within commensurate rating guidelines.

We expect no material effects from the current COVID-19 pandemic. We expect telecommunications companies like Telekom Austria to demonstrate relatively stable performance through the current COVID-19 pandemic. This is because the telecom sector's low cyclical and utility-like demand characteristics limit the correlation of its performance to weak macroeconomic conditions. However, we will continue to monitor the situation. We cannot rule out revisions to our forecast if our macroeconomic and GDP expectations deteriorate, or accelerated supplier payables or slower customer receivables collection increase the need for working capital beyond our assumptions.

Our ratings on Telekom Austria are somewhat insulated from the parent. AMX is the largest and controlling shareholder, with 51% of Telekom Austria's shares. We believe Telekom Austria's credit quality to be somewhat insulated from its parent, should we further lower the ratings on AMX. In particular, we think the company is operationally and financially separated from the group, and that Austria, which holds a 28% stake, acts as a significant minority shareholder, placing meaningful limitations on AMX's control.

Austria's minority stake is neutral to the rating. We continue to regard Telekom Austria as a government-related entity, based on the 28.4% stake held by Austria (AA+/Stable/A-1+). That said, our 'BBB+' rating on Telekom Austria is based on our stand-alone view of its credit quality, and does not include any uplift from potential extraordinary government support. This is because we see a low likelihood of timely and sufficient extraordinary support for Telekom Austria in the event of financial distress.

Outlook

The stable outlook reflects our expectation that Telekom Austria will sustain its sound operating performance and successfully manage its cost base, supported by management's prudent financial policy.

We therefore forecast S&P Global Ratings-adjusted debt to EBITDA and funds from operations (FFO) to debt will be sustained at comfortably below 2.5x and more than 35% respectively, while FOCF (excluding spectrum investments) to debt will strengthen toward 15%.

Downside scenario

Rating downside could occur if weaker operating performance or a more aggressive financial policy than currently forecast prevented the company from sustaining adjusted debt to EBITDA below 2.5x and increasing FOCF to debt toward 15%.

In addition, rating pressure could occur due to a multi-notch downgrade of AMX.

Upside scenario

We currently view rating upside as unlikely, since this would require an even more conservative financial policy that led to adjusted debt to EBITDA sustainably below 2.0x.

Company Description

Headquartered in Vienna, Telekom Austria is the leading telecom operator in Austria and a mobile operator in Bulgaria, Croatia, Belarus, Slovenia, Serbia, and Macedonia. It also provides fixed-line broadband, telephony, and TV services in all these countries except Serbia. In 2019, the domestic market contributed about 60% of the group's revenue and EBITDA.

Our Base-Case Scenario

- A recession in the eurozone, with GDP down 2% in 2020, bouncing back to 3% growth in 2021.
- About flat revenue in 2020, given the current difficult economic and operating environment, with organic annual revenue growth back to about 2% in 2021, compared with 5% in 2019. This rise is supported by positive service revenue trends in Austria and growth in mobile, fixed broadband, and TV in other markets.
- Approximately stable or very slightly progressing S&P Global Ratings-adjusted EBITDA margins, at about 34% in 2020-2022, based on International Financial Reporting Standards (IFRS) 16 accounting.
- Cash outflows for restructuring of €100 million annually.
- A temporary slowdown in capital expenditure (capex) in the current environment to €650 million-€700 million in 2020, and about €800 million annually thereafter, excluding spectrum costs. This is due to fixed broadband investments in Austria and mobile network upgrades in all markets, plus moderate spectrum costs in 2021.
- Negative working capital of €100 million this year, according to our conservative estimates.
- Annual dividends of about €150 million.
- Small bolt-on acquisition spending of €20 million annually.
- About €300 million in total cash outs for spectrum in 2021.

Based on these assumptions, we arrive at the following credit measures:

- Debt to EBITDA, adjusted by S&P Global Ratings and based on reported IFRS16 figures, of 2.2x-2.3x in 2020-2021, compared with 2.4x in 2019.
- Adjusted FFO to debt of 35%-40% over 2020-2021.
- Adjusted FOCF (excluding spectrum outlays) of about 15% thereafter.

Liquidity

We assess Telekom Austria's liquidity as strong, based on our expectation that the ratio of liquidity sources to uses will be higher than 1.5x in the 12 months started July 1, 2019. In addition, we assess Telekom Austria's financial risk management as prudent and think that it has well-established and solid relationships with banks, underpinned by repeated issuances at highly favorable terms and with a variety of lenders.

We estimate that principal liquidity sources over the 12 months from Dec. 31, 2019, include:

- Cash and liquid investments of about €147 million.

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- Availability of a €1 billion committed revolving credit facility (RCF) due 2024.
- Sizable FFO of €1.2 billion after leases.

For the same time period, we estimate that principal liquidity uses include:

- Short-term debt and commercial paper maturities of about €0.3 billion including licences.
- Capex of €0.7 billion.
- Dividends of €0.15 billion.

Issue Ratings - Subordination Risk Analysis

Capital structure

The vast majority of debt is senior unsecured debt located at the group's financing entity, Telekom Finanzmanagement GmbH.

Analytical conclusions

The long-term issue rating on the company's senior unsecured debt is 'BBB+', in line with the issuer credit rating, because no significant elements of subordination risk are present in the capital structure.

Ratings Score Snapshot

Issuer Credit Rating: BBB+/Stable/A-2

Business risk: Satisfactory

- Country risk: Intermediate
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bbb

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)

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- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: bbb+

- Group credit profile: BBB+
- Entity status within group: Moderately strategic (no impact)
- Sovereign rating: AA+
- Likelihood of extraordinary government support: Low (no impact)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology: The Impact Of Captive Finance Operations On Nonfinancial Corporate Issuers, Dec. 14, 2015
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Telecommunications And Cable Industry, June 22, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

Ratings List

Ratings Affirmed

Telekom Austria AG

Telekom Finanzmanagement GmbH

Issuer Credit Rating BBB+/Stable/A-2

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Ratings Affirmed

Telekom Austria AG

Senior Unsecured BBB+

Telekom Finanzmanagement GmbH

Senior Unsecured BBB+

Commercial Paper A-2

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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