

Research Update: Telekom Austria Upgraded To 'BBB+' On Solid Operating Performance; Outlook Stable

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Credit Rating: BBB+/Stable/A-2

■ Rationale

On June 29, 2005, Standard & Poor's Ratings Services raised its long-term corporate credit rating on Austrian telecommunications services provider Telekom Austria AG to 'BBB+' from 'BBB'. At the same time, the 'A-2' short-term corporate credit rating on the group was affirmed. The outlook is stable.

The upgrade reflects the continued solid operating performance by Telekom Austria combined with a conservative financial profile, despite dynamic shareholder return and acquisition policies.

Although Austria's telecoms market ranks among the most competitive within the EU, Telekom Austria's business risk profile has strengthened over the past few years. Specifically, the group has a strong track record in defending its leading market positions and performance was solid in 2004, with an EBITDA margin of 39% on revenues of €4.1 billion and strong free operating cash flow of €756 million. Importantly, the group has stabilized its performance in the wire-line business operation, despite competitive, regulatory, and technology pressures, and its domestic mobile operation is performing solidly in a fiercely competitive market, while international mobile operations are showing good performance.

At the same time, Telekom Austria has balanced--and is expected to continue to balance--its policies of shareholder returns and acquisitions with a conservatively leveraged balance sheet. For example, Telekom Austria's ratio of net debt (adjusted for operating leases, employee benefit obligations, and an asset-backed securitization program) to EBITDA was 1.5x at year-end 2004. Pro forma for the acquisition, expected in July 2005, of full control of MobilTel AD (BB+/Positive/--), the leading Bulgarian telecoms provider, for an enterprise value of €1.6 billion, Telekom Austria's adjusted net debt to EBITDA is expected to reach about 1.7x in 2005.

Telekom Austria has announced plans to increase its payout ratio to 65% in 2005, from 56% in 2004, and has in place a share buyback program for up to 6% of its share capital in 2005-2006. The group has also shown interest in buying control of Serbian mobile operator MobTel for an estimated price of several hundred million euros. Given Telekom Austria's strong free cash flow generation, ability to regulate the pace of its shareholder returns in case of acquisitions, and stated financial policy of preserving medium-term ratios of unadjusted net debt to EBITDA at less than 2x and EBITDA to net interest expenses at more than 8x, Standard & Poor's believes that the group has the ability and willingness to remain within the boundaries of a conservative financial profile.

The new ratings on Telekom Austria reflect the group's leading market position in all main segments of the Austrian telecoms

market, strong profitability and free operating cash flow, and a conservatively leveraged balance sheet. These factors are tempered by the fact that Austria's fixed-line and mobile telephony services markets are saturated and highly competitive and by the group's unrelenting expansion through acquisitions of mobile operations in southeastern Europe.

Liquidity

Liquidity was strong at March 31, 2005, with cash and equivalents of €1.24 billion and unused committed or agreed credit lines of €1.46 billion. Liquidity is also supported by strong free cash flow generation. The group's debt maturity profile is reasonably extended.

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■ Outlook

The stable outlook reflects our expectations that Telekom Austria will continue to defend successfully its domestic leading market positions, particularly in wireline, maintain strong margins and solid free cash flow generation, and follow a prudent financial policy. Specifically, Telekom Austria is expected to manage acquisitions and shareholder return policies consistent with a ratio of adjusted (for operating leases, asset-backed securitization, and employee benefit obligations) net debt to EBITDA not materially exceeding 2x and funds from operations to adjusted net debt of more than 30%.

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■ Risks Of Structural Subordination

Telekom Austria has announced plans to change the structure of the group in order to create a holding company where most of the present and future rated debt could be located. Standard & Poor's does not expect the new structure to result in a material impairment of the position of financial debtors at the parent company, given that the group is expected to put in place intercompany guarantees from main operating companies as well as appropriate intercompany loans, granting them direct claim on operating assets. Standard & Poor's will monitor the timely execution of Telekom Austria's plans in this respect.

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■ Ratings List

	TO	FROM
Telekom Austria AG		
Corporate credit rtg	BBB+/Stable/A-2	BBB/Positive/A-2
Senior unsecured debt	BBB+	BBB

NB: This list does not include all ratings affected.

Ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com. It can also be found on Standard & Poor's public Web site at www.standardandpoors.com; under Credit Ratings in the left navigation bar, select Find a Rating, then Credit

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