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## Telekom Austria AG Outlook Revised To Stable On Modest Trading Prospects; BBB+/A-2 Rtg's Affrmd

### **Rationale**

On June 20, 2007, Standard & Poor's Ratings Services revised its outlook on Austrian telecommunications operator Telekom Austria AG to stable from positive, following a review of the group's business prospects and financial plans. At the same time, the long- and short-term corporate credit ratings were affirmed at 'BBB+' and 'A-2'.

The outlook revision reflects Telekom Austria's overall modest trading prospects due to fierce competitive pressure in Austria, the expected negative impact of the significant reduction of international roaming charges initiated by the European Commission, and lower growth prospects for its international mobile subsidiaries. It also acknowledges management's readiness to accept a deterioration in credit quality to 'BBB' if adequate growth opportunities were to arise.

Telekom Austria's domestic operating performance in the first quarter ended March 31, 2007, was significantly burdened by fierce price competition, start-up losses for the new green-field mobile operations in Serbia and Macedonia, continuing fixed-to-mobile substitution, and lower mobile termination fees. This was only partly offset by good uptake of broadband services, cost cutting, and higher mobile subscriptions. EBITDA generation of domestic fixed-line and mobile operations declined by 10.3% and 7.1% year on year. Furthermore, the significant reduction of international roaming charges (expected to be effective in the second half of 2007), along with further fixed-to-mobile termination rate cuts, is likely to weigh meaningfully on Telekom Austria's domestic mobile earnings.

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The group's international mobile operations, which have grown significantly in recent years and generated good margins and free operating cash flow (FOCF), should also post lower growth rates in the medium term due to higher penetration rates and increasing competition. In addition, green-field operations in Serbia and Macedonia are not expected to break even before 2009 and 2010, respectively.

Nevertheless, the group maintains solid domestic broadband, mobile, and fixed-line voice market positions and generated sound operating margins of 40% and FOCF of EUR932 million (excluding EUR330 million mobile license costs) in the 12 months ended March 31, 2007. Telekom Austria's strong FOCF generation gives it the necessary financial flexibility to fund a certain level of acquisitions, dividends, and share buybacks while maintaining conservative debt-ratio targets. Under its current financial policy for the years 2007-2010, the group aims to buy back up to 10% of its common stock in the next 24 months if it does not find profitable growth projects in Eastern- and South-Eastern Europe, and targets a dividend payout ratio of 65%. In addition, the group has an unadjusted net debt to EBITDA ratio target of 2x, compared with 1.6x at March 31, 2007. This remains consistent with the ratings. On Standard & Poor's adjusted basis (that is, mainly adjusting for operating leases and employee benefit), this ratio was 1.7x at March 31, 2007.

### ***Liquidity***

Telekom Austria's liquidity was strong at March 31, 2007, with EUR121 million cash on hand and access to EUR2.3 billion of committed or agreed lines of credit, of which EUR0.3 billion was drawn. Liquidity is also supported by strong free cash flow generation. The group's debt maturity profile is unchallenging.

### ***Outlook***

The stable outlook reflects Standard & Poor's expectation that Telekom Austria will continue to successfully defend its leading domestic and international market positions, maintain solid operating margins (notably in its domestic market through active streamlining of its cost structure where possible), and consequently generate sustainable, robust FOCF. In addition, we expect its financial policy to remain broadly within the communicated guidelines over the medium term, although there would be some headroom at the rating level for temporarily higher leverage, provided it is contained within approximately 2.5x EBITDA and is for a limited timeframe.

The outlook could be revised to negative if Telekom Austria's EBITDA or cash flow base deteriorated, or if it shifted its financial policy to target more aggressive leverage ratios than at present, although this is not foreseen at this stage. We do not foresee rating upside at present, given the fierce competition in Austria, high pressure on operating margins from the lower international roaming charges, and start-up expenses for the green-field operations in Serbia and Macedonia.

***Ratings List***

	To	From
Austria Telekom AG Corporate credit rating	BBB+/Stable/A-2	BBB+/Positive/A-2
Telekom Finanzmanagement GmbH Senior unsecured debt*	BBB+	BBB+

\*Guaranteed by Austria Telekom AG

Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at [www.ratingsdirect.com](http://www.ratingsdirect.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com); under Credit Ratings in the left navigation area, select Find a Rating, then Credit Ratings Search.

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