

Rating Action: Moody's downgrades Telekom Austria to Baa1; stable outlook

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Madrid, January 19, 2012 -- Moody's Investors Service has today downgraded to Baa1 from A3 the senior unsecured and issuer ratings of Telekom Austria. Concurrently, Moody's has affirmed Telekom Austria's Prime-2 (P-2) short-term issuer rating. The rating outlook is stable.

For a full list of the ratings affected, please see below.

Telekom Austria AG

Long-Term Issuer Rating, downgraded to Baa1 from A3

Short-Term Issuer Rating of P-2, affirmed

Senior Unsecured Medium-Term Note (domestic currency) ratings downgraded to (P)Baa1 from (P)A3

Telekom Finanzmanagement GmbH

BACKED Senior Unsecured (domestic currency) ratings, downgraded to Baa1 from A3

BACKED Senior Unsecured Medium-Term Note (domestic currency) ratings downgraded to (P)Baa1 from (P)A3

Other BACKED Short-Term (domestic currency) ratings of (P)P-2, affirmed

RATINGS RATIONALE

"Today's rating action reflects our expectation that Telekom Austria's operating performance will remain weak, affected by regulation, fierce competition and the adverse macroeconomic conditions in Austria as well as in other countries in which the group operates," says Carlos Winzer, a Moody's Senior Vice President and lead analyst for Telekom Austria. "In addition, we anticipate that expected investments, such as the upcoming spectrum auctions, will exert further pressure on Telekom Austria's financial ratios and that this will not be completely offset by the group's recently announced cut in dividends," explains Mr Winzer. "As a result, we consider that the group's adjusted leverage and retained cash flow/debt metrics will no longer be in line with those expected for the previous rating category."

Telekom Austria's Baa1 rating takes into consideration: (i) the group's scale; (ii) its position as a strong integrated player in the highly competitive domestic market and a geographically diversified leading mobile operator in Austria and the countries in which it operates in Eastern Europe; and (iii) its continued solid cash flow generation. The company has a public capital structure guidance including reported net debt to EBITDA of between 2x and 2.5x. Telekom Austria's standalone credit quality or baseline credit assessment (BCA) of 9 (lowered from BCA 8 in the context of today's action) is equivalent to Baa2 in the Moody's global ratings scale. Moody's has adjusted some of the inputs for Telekom Austria's ratings under its methodology for Government-Related Issuers (GRIs). Specifically, Moody's has increased the dependence factor from 'low' to 'moderate'. The final Baa1 rating currently benefits from a one-notch uplift as a result of Telekom Austria being 28.42% government-owned, the group's moderate level of default dependence on the state and moderate support assumptions.

The stable outlook reflects Moody's expectation that Telekom Austria will retain its strong market position

in Austria, weathering macro-economic and competitive pressures in the markets where it operates, and that management will preserve the financial strength within the publicly stated ratio guidance. We expect flat to slight revenue declines in the short to medium term broadly offset by ongoing efforts to sustain margins and cash flow. Strategic investments, as well as shareholder remuneration, are expected to be managed within the financial ratio guidance for this rating level, which includes adjusted gross debt/Ebitda comfortably below 3x and adjusted retained cash flow/gross adjusted debt around the mid twenties.

From a liquidity risk management perspective, Moody's believes that Telekom Austria's liquidity profile is becoming more constrained. The rating agency notes Telekom Austria's EUR1 billion debt maturing in 2012. In addition, the group will face a significant amount of capital expenditure, together with expected spectrum payments, and dividends of EUR160 million during 2012. However, at the end of September 2011, Telekom Austria had around EUR316 million in cash and cash equivalents. The group's external liquidity sources include EUR1 billion worth of committed long-term bank facilities, which were mostly unutilized as of January 2012, and can be drawn at any time, not being subject to material adverse change (MAC) clauses or financial covenants.

WHAT COULD CHANGE THE RATING UP/DOWN

The ratings could come under further downward pressure if (i) Telekom Austria's underlying operating performance were to weaken beyond current expectations as a result of adverse macroeconomic, regulatory or competitive developments or (ii) the group were to make additional material debt-financed acquisitions and/or increase shareholder remuneration, such that its credit metrics were to deteriorate (reflected in adjusted retained cash flow (RCF)/adjusted gross debt trending towards 20% and adjusted gross debt/EBITDA trending towards 3.0x). Negative pressure could also be exerted on the rating if the group's liquidity profile were to weaken further.

In addition, although there are currently no indications of it, Moody's would most likely no longer apply its government-related issuer methodology to Telekom Austria or incorporate uplift in its final rating if the government were to reduce its stake in the group to below 20% or Moody's considered to lower support assumptions. On its own, this would likely result in a one-notch downgrade.

Conversely, although not currently expected, Moody's could consider upgrading Telekom Austria's rating if the group's debt protection ratios were to strengthen as a result of improvements in its operational cash flows. Assuming no change in the sovereign rating or the levels of government support and default dependence, the rating could come under positive pressure if it were to become clear that the group would achieve improvements in its debt protection ratios, such as an adjusted RCF/gross adjusted debt ratio trending towards 30% and a gross adjusted debt/EBITDA ratio that is comfortably lower than 2.5x on a sustainable basis.

PRINCIPAL METHODOLOGIES

The principal methodology used in rating Telekom Austria AG was the Global Telecommunications Industry Methodology published in December 2010. Other methodologies used include the Government-Related Issuers methodology published in July 2010. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

Headquartered in Vienna, Austria, Telekom Austria is a leading provider of telecommunication services in Austria, with 2.3 million fixed voice lines, almost 1.2 million fixed-line broadband connections and serving 5.2 million mobile customers as of September 2011. The group has a nationwide presence, delivering a full range of services and products, including telephony, data exchange, interactive contents, TV and information and communications technology (ICT) solutions. The group has also expanded its mobile operations outside Austria, where its customer base accounts for more than 19 million subscribers. Telekom Austria is one of the leading mobile operators in Bulgaria (through its subsidiary Mobiltel), Belarus (Velcom) and Croatia (Vipnet), and is also present in Slovenia (Si.mobil), Macedonia (Vip operator), Serbia (Vip mobile) and Liechtenstein.

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