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Research

Research Update:

Telekom Austria Upgraded To 'BBB' On America Movil Takeover And Capital Increase; Outlook Stable

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Overview

- Following a public tender, Mexico-based telecommunications company América Móvil S.A.B. de C.V. (AMX) is now the controlling shareholder of Telekom Austria, with a stake of about 51%.
- We view Telekom Austria as a "moderately strategic" subsidiary of AMX, and we anticipate that the planned capital increase will primarily be used for debt reduction.
- We are raising to 'BBB/A-2' from 'BBB-/A-3' our corporate credit ratings, and raising all issue ratings on its debt. We are also removing all ratings from CreditWatch positive.
- The stable outlook reflects our expectation that operating performance in Austria will stabilize and the maintenance of a Standard & Poor's-adjusted debt to EBITDA ratio of about 3x after the capital increase.

Rating Action

On Aug. 11, 2014, Standard & Poor's Ratings Services raised its long-term corporate credit rating on Austria-based telecommunications operator, Telekom Austria AG, to 'BBB' from 'BBB-' and raised its short-term rating to 'A-2' from 'A-3'. At the same time, we raised all issue ratings on its debt. We also removed all ratings from CreditWatch, where we had placed them with positive implications on May 2, 2014. The outlook is stable.

Rationale

The upgrade follows the recent completion of a tender offer by América Móvil S.A.B. de C.V. (AMX; A-/Stable/--; CaVal (Mexico) national scale mxAAA/Stable/mxA-1+) to purchase outstanding shares in Telekom Austria in July 2014. As a result, AMX is currently the controlling shareholder in Telekom Austria, with a stake of about 51%. Furthermore, it reflects the expected improvement in the group's credit metrics due to the planned capital increase in the second half of 2014.

We base our upgrade primarily on our assessment of Telekom Austria as a "moderately strategic" subsidiary to AMX following the successful takeover. This assessment primarily reflects our view that Telekom Austria is unlikely to be sold over the medium term. We understand that the group intends to use

Telekom Austria as a vehicle for expansion into Europe, particularly into the Central and Eastern Europe (CEE) region. In our view, AMX has recently shown clear interest in expanding its presence outside of Latin America. For example, it attempted to take over Dutch telecommunications provider KPN in August 2013. 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.

Nevertheless, given that Telekom Austria represents a relatively insignificant part of AMX's revenues (less than 10%), that it operates outside its core countries in Latin America, that AMX's stake in Telekom Austria remains limited at only 51%, and that we do not anticipate any cross-default clauses between both entities or financial guarantee for Telekom Austria's debt by AMX, we don't consider its strategic importance to be higher than moderately strategic at this stage. Furthermore, we do not anticipate any meaningful operational integration between AMX and Telekom Austria.

We continue to assess Telekom Austria's stand-alone credit profile at 'bbb-', based on its "satisfactory" business risk profile and "significant" financial risk profile.

We assume that the planned capital increase will take place during the second half of 2014 and that AMX and the Austrian government will subscribe for most of the new shares. We assume that the proceeds from the planned €1 billion capital increase will primarily be used to repay debt, supporting meaningful deleveraging at Telekom Austria and the improvement of credit metrics to a level comfortably within the range expected at the current rating. We expect the capital increase to contribute to a reduction in adjusted leverage to about 3.0x at year-end 2014.

Telekom Austria's business risk profile remains "satisfactory," primarily reflecting our view of the group's solid competitive position in Austria and its profitable and cash-generative international mobile operations. This is partly offset by the high competitive and regulatory pressure in many of its service areas; high exposure to country risk, especially in Belarus; and rigid cost structure in Austria.

Our base case assumes:

- Revenue will decline by about 3%-4% in 2014, compared with 3.4% in 2013, and then decline more moderately in 2015 by about 1%-2% as a result of lower competitive and regulatory pressures, especially in Austria.
- The group's EBITDA margin, as adjusted by Telekom Austria, will improve to about 32% in 2014 from 31% in 2013, and gradually improve further thereafter. We think the margin recovery will primarily be due to lower mobile market investments and less-intense competition in Austria, continued cost-cutting efforts, and improving revenue trends.
- A capital increase of €1 billion, which will be used for debt reduction as well as potential M&A and investments.
- Total capital expenditures of about €0.7 billion a year in 2014 and 2015,

up from €650 million in 2013. Spectrum costs will be moderate in 2014-2016.
- Dividend payments will remain stable in 2014 and 2015.

This results in the following credit metrics:
- Standard & Poor's-adjusted debt-to-EBITDA ratios of about 3.0x and 2.8x-2.9x at year-end 2014 and 2015, respectively, compared with 3.7x at year-end 2013.
- Adjusted funds from operations (FFO) to debt ratios of about 26% and 27% at year-end 2014 and 2015, respectively, compared with 22% at year-end 2013.
- FOCF to debt of about 5% in 2014 and 2015.

Liquidity

The short-term rating is 'A-2', reflecting the long-term rating of 'BBB' on Telekom Austria and our assessment of the group's liquidity as "strong" under our criteria.

Under our base case, we calculate that the ratio of liquidity sources to uses will exceed 1.5x in 2014 and 2015.

We calculate the following principal liquidity sources:
- Surplus cash of about €200 million; and
- FFO of about €1.05 billion.

Against these sources, we calculate that Telekom Austria has the following liquidity uses:
- No debt maturities in 2014 and 2015, as we assume the company's maturing loans will be repaid with funds received from the capital increase;
- Capital expenditure of about €0.7 billion;
- Moderately negative working capital requirements;
- Moderate cash outflows related to spectrum investments; and
- Modest annual shareholder dividends (€22 million) and coupon payments on the group's hybrid bonds. We treat 50% of the annual coupon payment of €34 million as dividend payment and 50% as interest payment.

Outlook

The stable outlook reflects our expectation that operating performance in Austria will stabilize and that Telekom Austria will maintain an adjusted debt-to-EBITDA ratio of about 3x after the capital increase in the second half of 2014. We see leverage of about 3.0x as commensurate with the current SACP of 'bbb-'.

Downside scenario

Although not expected at this stage, we could consider a downgrade if the company's revenues and margins continue to decline due to increased competition in Telekom Austria's international operations, leading leverage to rise to more than 3.25x and FFO to debt to fall to less than 25%. We could also lower the rating if Telekom Austria plans to primarily use the proceeds from the capital increase for acquisitions, rather than debt reduction.

The rating on Telekom Austria has one notch of uplift to reflect support from AMX. The rating would therefore likely come under pressure if we reassessed Telekom Austria's status in the AMX group as "nonstrategic", for example, if Telekom Austria appeared likely to be sold over the near term, a scenario which we consider to be unlikely.

Upside scenario

We could consider an upgrade if Telekom Austria were to improve its revenues and profitability more quickly than we currently expect, leading to more meaningful deleveraging over the next two years. A positive rating action would depend on a debt-to-EBITDA ratio, after our adjustments, of less than 2.75x and the free cash flow-to-debt ratio improving to about 10%.

In the medium term, we could also raise the rating on Telekom Austria if we reassessed it as a more strategically important subsidiary of AMX. This could happen if we were to witness more implicit support from AMX, for example, if AMX were to guarantee Telekom Austria's debt.

Ratings Score Snapshot

Corporate Credit Rating: BBB/Stable/A-2

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

Financial risk: Significant
- Cash flow leverage: Significant

Anchor: bbb-

Modifiers:
- Diversification: Neutral (no impact)
- Quality of capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and Governance: Satisfactory (no impact)
- Comparable Rating Analysis: Neutral (no impact)

Stand-alone credit profile: bbb-
- Sovereign rating: AA+/Stable/A-1+
- Likelihood of government support: Low (no impact)
- Group credit profile: a-
- Group status: Moderately strategic (+1 notch)

Related Criteria And Research

Related criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

Related research

- Telekom Austria 'BBB-/A-3' Ratings Placed On CreditWatch Positive On America Movil Takeover Bid And Capital Increase, May 2, 2014

Ratings List

Upgraded; CreditWatch/Outlook Action

	To	From
Telekom Austria AG		
Corporate Credit Rating	BBB/Stable/A-2	BBB-/Watch Pos/A-3
Junior Subordinated	BB+	BB/Watch Pos
Telekom Finanzmanagement GmbH		
Senior Unsecured*	BBB	BBB-/Watch Pos
Commercial Paper*	A-2	A-3/Watch Pos

*Guaranteed by Telekom Austria AG

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