

Research Update:

# Telekom Austria AG Upgraded To 'A-' On Continuous Deleveraging; Outlook Stable

October 25, 2022

## Rating Action Overview

- Following Telekom Austria AG's solid results over the first nine months of 2022, including the resilience of its EBITDA margin despite macroeconomic headwinds, we have upwardly revised our expectations for its performance in 2023 and 2024, leading us to forecast annual free operating cash flow (FOCF) generation of about €500 million-€600 million.
- The combination of a strong operating performance with management's supportive and prudent financial policy leads us to estimate that the company will maintain S&P Global Ratings-adjusted leverage of less than 2.0x after gradually deleveraging from 2.3x in 2020.
- Therefore, we raised our long-term issuer credit rating on Telekom Austria to 'A-' from 'BBB+', and affirmed our 'A-2' short-term rating.
- The stable outlook reflects our expectation that the company will maintain S&P Global Ratings-adjusted leverage sustainably below 2.0x, funds from operations (FFO) to debt above 45%, and FOCF to debt before spectrum payments comfortably above 15%.

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## Rating Action Rationale

**Telekom Austria's solid operating performance and strong free cash flow generation supported its resilience despite macroeconomic headwinds.** Following its outperformance of our 2021 forecast and resilience during the first nine months of 2022, we have revised our 2023 and 2024 revenue and EBITDA expectations. Telekom Austria increased its revenue by 4.6% during the first nine months of 2022, primarily by increasing its mobile service revenue across geographies. The company managed to translate this positive revenue trend into a 7.6% increase in its EBITDA for the same period. This leads us to expect Telekom Austria will improve its S&P Global Ratings-adjusted EBITDA margin to close to 37.0% in 2022-2024, which compares with 35.8% in 2021 and 34.5% in 2020. That said, we see limited room for further improvements in the company's margin during our forecast period due to our expectation for inflationary pressure on its operating costs and rising energy prices. However, we expect that Telekom Austria will at least maintain this level of EBITDA, which will support annual S&P Global Ratings-adjusted FOCF of about €500 million-€600 million in 2023-2024.

**In our view, management's prudent and supportive financial policy will support leverage of comfortably below 2.0x.**

We expect Telekom Austria will adhere to its financial policy, which targets maximum net debt to EBITDA excluding leases of 1.4x (S&P Global Ratings-adjusted leverage of about 1.8x-1.9x). Furthermore, based on our assumption that the company will continue to increase its dividend at a conservative pace and provide shareholder distributions of about €200 million annually (substantially below our FOCF expectations), there is some potential it will further deleverage toward 1.5x over the forecast period.

**Heightened geopolitical risks could negatively affect its operations in Belarus and potentially slow its deleveraging, though we believe it has some headroom.**

In our view, Telekom Austria's Belarusian operations are the most vulnerable to the increasing geopolitical risks in Europe. So far, we have not seen any material effects from sanctions on its performance, given that it increased its revenue by 10% and its EBITDA by 19% over the first nine months of 2022. However, there have been some recent regulatory changes in the country, including increased taxation on advertisements and an additional fee to broadcast state-channels. Furthermore, we believe there is some risk of continued volatility in the Belarussian Ruble, which appreciated by 14.4% on average in the third quarter of 2022, and potential further sanctions or regulations that may impact the company's telecom operations in the country. That said, Telekom Austria's Belarussian operations only account for about 10% of its EBITDA, thus we expect that any disruption in this segment would have a limited effect on our forecast credit ratios or business assessment.

**Our ratings on Telekom Austria are somewhat insulated from our ratings on its parent.**

In our view, Telekom Austria's credit quality is somewhat insulated from that of its largest and controlling shareholder, America Movil S.A.B. de C.V. (AMX), which holds a 51% stake in the company. In particular, we think Telekom Austria is operationally and financially separated from the AMX group and that the Austrian government, which holds a 28% stake, acts as a significant minority shareholder by placing material limitations on AMX's control. As such, we could rate Telekom Austria above the parent, but currently our ratings on the two entities are at the same level.

## Outlook

The stable outlook on Telekom Austria reflects our expectation that it will maintain S&P Global Ratings-adjusted leverage sustainably less than 2.0x, FFO to debt above 45%, and FOCF to debt before spectrum payments of more than 15%.

## Downside scenario

We could lower our rating on Telekom Austria if its operating performance is weaker than anticipated or it pursues a more aggressive financial policy such that its S&P Global Ratings-adjusted debt to EBITDA sustainably exceeds 2.0x.

In addition, we could lower our rating if we undertake a multi-notch downgrade of AMX.

## Upside scenario

We regard an upgrade of Telekom Austria as remote because this would require a significant diversification of its business, likely combined with a further strengthening of its financial risk

profile.

In addition, we could raise our rating if we undertake a multi-notch upgrade of AMX.

## 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 of these countries except Serbia. In 2021, the company's domestic market contributed about 56% of its revenue and EBITDA.

## Our Base-Case Scenario

- Eurozone GDP expands by 3.1% in 2022, about 0.3% in 2023, and 1.8% in 2024;
- Eurozone Consumer Price Index (CPI) rises by 8.0% in 2022, about 5.2% in 2023, and 2.0% in 2024;
- Revenue increases by about 2%-4% in 2022-2024, primarily on improving mobile service revenue in Austria and in the Central and Eastern European (CEE) markets, which is somewhat offset by a decline in fixed-line legacy product revenue in Austria;
- S&P Global Ratings-adjusted margin of about 36%-37% in 2023-2024. We assume the company's revenue growth will be offset by rising operating costs due to inflation and increased energy costs, which will cause its EBITDA margin to remain at par with our expectations for 2022;
- Capital expenditure (capex) to sales of close to 20% in 2022-2024, up from 13% in 2020. The higher capex primarily relates to its fiber roll-out in Austria;
- Spectrum payments of about €100 million per year in 2023-2024; and
- Dividend increases €0.02 per share per annum, leading to an expected dividend payout of between €180 million-€200 million per year in 2022-2024.

Based on these assumptions, we forecast the following:

- S&P Global Ratings-adjusted debt to EBITDA of about 1.7x in 2022, further improving toward 1.5x in 2022 (down from 2.3x in 2020);
- S&P Global Ratings-adjusted FFO to debt improving to about 50% in 2022 and toward 55% in 2024 (up from 47% in 2021); and
- S&P Global Ratings-adjusted FOCF, excluding outlays on spectrum, of about 18%-20% in 2022-2024 (similar to 20% in 2021).

## Liquidity

We revised our assessment of Telekom Austria's liquidity to adequate from strong to reflect its increased reliance on short-term funding. As per our liquidity calculations, dated Sept. 30, 2022, the company's sources of liquidity will no longer be 1.5x its uses, which is a requirement for a strong assessment. However, we still estimate its sources will be comfortably above 1.2x its uses and regard it as having prudent risk management, a good standing in the credit markets, and solid relationships with its banks, which support our adequate assessment. In addition, since the end of

## Research Update: Telekom Austria AG Upgraded To 'A-' On Continuous Deleveraging; Outlook Stable

the third-quarter, Telekom Austria's has signed an additional €200 million revolving credit facility (RCF) effective Oct. 14, 2022, and prolonged the maturity of a €300 million term loan coming due in the next 12 months.

Principal liquidity sources:

- Cash and liquid investments of about €172 million;
- Availability under a committed RCF due 2024, of which €1.27 billion is undrawn; and
- Sizable FFO of €1.4 billion–€1.5 billion.

Principal liquidity uses:

- Debt maturities of about €1.2 billion over the next 12 months;
- Annual capex of about €1.0 billion; and
- Dividends of about €190 million.

## Ratings Score Snapshot

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

Business risk: Satisfactory

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

Financial risk: Modest

- Cash flow/leverage: Modest

Anchor: bbb+

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate
- Management and governance: Satisfactory
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: a-

- Group credit profile: a-
- Entity status within group: Moderately Strategic (no impact)
- Related government rating: 'AA+'
- Likelihood of government support: Low (no impact)

**ESG credit indicators: E-2, S-2, G-2**

**Related Criteria**

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- 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 | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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: Principles Of Credit Ratings, Feb. 16, 2011

**Ratings List**

<b>Upgraded; Ratings Affirmed</b>		
	<b>To</b>	<b>From</b>
<b>Telekom Austria AG</b>		
<b>Telekom Finanzmanagement GmbH</b>		
Issuer Credit Rating	A-/Stable/A-2	BBB+/Stable/A-2
Upgraded		
	To	From
Telekom Austria AG		
Telekom Finanzmanagement GmbH		
Senior Unsecured	A-	BBB+
Ratings Affirmed		
	To	From
Telekom Austria AG		

## Research Update: Telekom Austria AG Upgraded To 'A-' On Continuous Deleveraging; Outlook Stable

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### Upgraded; Ratings Affirmed

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	To	From
Telekom Finanzmanagement GmbH		
Commercial Paper	A-2	A-2

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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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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