

Global Credit Research - 19 Jul 2011

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Ratings

Category	Moody's Rating
Outlook	Stable
Senior Unsecured	A3

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Key Indicators

EVN AG	2009/2010	2008/2009	2007/2008
(FFO + Interest) / Interest Expense	7.1x	5.0x	5.5x
FFO / Net Debt	21.9%	19.2%	24.9%
RCF / Net Debt	18.0%	14.5%	19.2%
FCF / Net Debt	3.7%	-5.9%	-4.2%

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

Opinion

Corporate Profile

EVN AG ("EVN", rated A3, stable outlook), is a multi-utility with primary focus on the province of Lower Austria, where the company generates approximately 60% of revenues and 80% of EBITDA. EVN is the second-largest Austrian electric utility, with its energy activities (comprising electricity generation, distribution and supply; gas distribution and supply; and district heating) accounting for approximately 90% of revenues as of YE 2009/10. Other operations include environmental services (including water, wastewater and waste incineration) and strategic investments and shareholdings, mainly comprising Austria's largest generator Verbund (13% stake, rated A2, stable outlook), the regional electric and gas utilities BEWAG and BEGAS (36% stake) and the Austrian oil and gas company Rohol-Aufsuchungs AG (50% stake).

EVN's main shareholders are the province of Lower Austria (51% ownership) and the German gas and electricity company EnBW (32.5% stake, rated A2, negative outlook), with the balance (16.5%) being free float.

Recent Developments

In June 2011, EVN announced the acquisition of a 13% stake in 13 hydro plants on the Inn River, owned by Verbund. The acquisition price (not disclosed) was based on the price originally paid by Verbund plus an adequate interest. EVN will be granted pro-rata electricity procurement rights at market prices for the energy generated by the 13 hydro plants. The transaction was formally closed at the beginning of July 2011.

In May 2011, EVN announced a delay in the commissioning of the 49%-owned 790MW coal-fired power plant in Duisburg-Walsum, initially expected for mid-2011. The company expects commissioning to be delayed by one to two years due to issues with the plant's boiler.

Rating Rationale

EVN's rating reflects the company's strong competitive position in Lower Austria and the material proportion of EBITDA deriving from regulated domestic network activities, partially balanced by its relatively short generation position vs. supply requirements and the growing importance of higher risk international activities. The rating also incorporates the expectation that the company's significant investment programme, in conjunction with the recent acquisition of a stake in hydro generation assets and the potential impact of the delay in the commissioning of the Duisburg-Walsum power plant, will weigh on its financial profile, thus limiting financial flexibility. EVN's A3 rating includes a one-notch uplift from its stand-alone credit quality for potential support from its main shareholder, the Province of Lower Austria.

DETAILED RATING CONSIDERATIONS

On the basis of the 51% stake held by the Province of Lower Austria via the holding company NÖ Landes-Beteiligungsholding GmbH, EVN is

considered a Government Related Issuer ("GRI") under Moody's methodology, which was updated in July 2010. Accordingly, the company's A3 rating reflects the combination of the following factors:

- Baseline credit assessment ("BCA") of 8 (on a scale of 1-21, where 1 represents the equivalent risk of a Aaa, 2 a Aa1, 3 a Aa2 and so forth, with 8 mapping to the "Baa1" rating category). The BCA is a representation of EVN's stand-alone credit profile;

- Aaa/stable outlook local currency rating of the Province of Lower Austria;

- Moderate degree of dependence, which reflects the fact that EVN still generates the majority of its earnings in Lower Austria, although with a decreasing trend considering its growing international exposure;

- Moderate support, which reflects EVN's stable ownership structure, supported by the federal and provincial constitutional law requiring a minimum 51% stake to be owned by the Province of Lower Austria, and the economic importance of EVN as the main supplier of utility services in Lower Austria. In this context, despite the growing importance of international activities outside the area of Lower Austria, Moody's understands that the government owners have so far been supportive of the existing expansion strategy.

As a result of these parameters, EVN's A3 rating currently incorporates a one-notch uplift from its stand-alone credit quality for potential government support.

Baseline Credit Assessment

When assessing EVN's BCA, Moody's applies its rating methodology for Unregulated Utilities and Power Companies, published in August 2009. The methodology examines the core factors that Moody's considers most relevant to unregulated utilities, sets out the range of possible outcomes by factor and maps these to a rating range. Each factor is appropriately weighted and, in combination, contributes to the rating output by the methodology grid. Measurements are quantitative where an appropriate metric is defined. However, for some sub-factors, qualitative judgment is necessary to determine the appropriate category. For illustrative purposes, the methodology relies upon historical financial results, while ratings incorporate Moody's expectations for future performance. The suggested rating under the methodology grid for EVN is Baa1, as summarised in the table below and based on the September 2008-September 2010 average key credit metrics. The suggested rating is in line with EVN's BCA of 8 (Baa1), and reflects the recent deterioration in EVN's historical financial profile, following its international expansion and substantial investment programme.

FACTOR 1: MARKET ASSESSMENT, SCALE AND COMPETITIVE POSITION

Moody's assessment of EVN under this factor focuses on the company's entrenched market position within the Federal State of Lower Austria. Although relatively small compared to its pan-European peers when considering the absolute size of its operations - total assets were EUR6.7 billion at September 2010 (equivalent to approximately USD9.2 billion) - EVN's established market position and strong regional presence helps to mitigate against competitive pressures. Moody's scores the company single-A for the scale of its operations.

Whilst competition has been intensifying, particularly in the electricity segment since liberalisation of the market, EVN still benefits from a very strong market position in its core area (almost 80% in Lower Austria) and relatively low churn rates. EVN's main competitor on the electricity supply side is Verbund. However, when assessing EVN's overall positioning Moody's takes into account the broader German-Austrian wholesale energy market, which is characterised by strong interlinkage. Moody's also notes, that the competitive position is less well established in EVN's international activities, with a supply market share in Bulgaria of only around 30%. Overall, Moody's scores EVN Baa under its methodology for competitive position.

FACTOR 2: CASH FLOW PREDICTABILITY OF BUSINESS MODEL

Whilst recognising the strength of EVN's supply business in Lower Austria, Moody's assessment also reflects the company's exposure to procurement cost volatility given EVN's short generation position, particularly in relation to its international activities. Moody's has taken into account that the company's planned investments in generation capacity are designed to address this imbalance.

EVN's generation portfolio comprises 1,787 MW of installed generation capacity, of which 80% is thermal and 20% from renewable energy sources, primarily hydro and wind. However, given the relatively high load factors of EVN's renewable power generation capacity (largely hydro power plants), the share of renewable output has historically been around 30%. This share may decline over the medium-term following the commissioning of the coal-fired Duisburg-Walsum power plant, therefore creating higher exposure to coal prices and increasing the CO₂ emissions of EVN's generation portfolio. However, this is partially balanced by the additional contribution deriving from the electricity procurement rights associated with the hydro plants recently acquired. Overall, Moody's scores EVN in Baa for fuel strategy and mix. However, Moody's understands that it is management's long-term goal to increase the portion of EVN's energy generated from renewable sources to 50%.

The company's existing generation capacity currently covers approximately 60% of its requirements in Lower Austria, but only approximately 20% of needs on a group basis, given the company's sizeable position in the Bulgarian and Macedonian electricity supply market and very limited generation capacity in these countries. In light of this unbalanced consolidated generation/supply position, the company is materially reliant on external procurements, thus generally exhibiting less flexibility in its customer price-setting process and vulnerability to potentially volatile wholesale prices. The exposure deriving from this unbalanced upstream position should be mitigated over the medium term by the planned increase in generation capacity, as the company aims to meet its electricity requirements through 40%-60% own generation on a group basis. The commissioning of the coal plant in Duisburg-Walsum (790 MW capacity, with EVN's stake at 49%), initially expected for mid-2011 but likely to be postponed by one to two years due to technical problems, would be the first step towards this objective, and should lead to a coverage of approximately 33% on a group basis. Taking into account the very strong integration within its home market, somewhat offset by the weaker positioning in its international operations, Moody's scores EVN in the single-A-category for degree of vertical integration.

Over the period to 2012/13, EVN plans to consolidate the implementation of its investment programme, with annual capex expected to reach approximately EUR400 million per annum. Investments will be mainly focused on the expansion of the company's generation position and increased upstream integration and the strengthening of its renewables base. Whilst recognising that planned capex will boost EVN's earnings in the medium to long term, Moody's notes that in the shorter term cash generation associated with the current envisaged level of debt-financed investment spending will be relatively limited. Moody's scores the company Ba for its capital requirements in comparison to existing net property, plant and equipment.

Currently, around one third of EVN's EBITDA derives from its low risk Austrian electricity and gas network businesses, which present quasi-monopolistic characteristics and produce stable cash flows for the company, underpinning EVN's risk profile and cash flows visibility. Energy network activities in Austria are subject to a relatively new regulatory framework. An incentive-based tariff regime was introduced in January 2006 for electricity networks and in February 2008 for gas networks. The system is based on a RPI-X approach, where the RPI factor is the network cost index and the general productivity factor is 1.95%. In addition, based on a benchmarking exercise, individual efficiency factors of up to 3.5% and 4.85% were set for the Austrian electricity and gas network operators, respectively. Moody's notes that EVN's efficiency factor is close to zero. In Moody's view, the introduction of the new incentive-based regulatory model has created more certainty for EVN, as the regulatory period for which tariffs are set on an ex-ante basis covers four years for electricity and five for gas (previously, they were subject to annual review). Based on this new regulatory system, Moody's expects a relatively stable development of EVN's earnings from network activities where potential lower tariffs should be mostly offset by increasing volumes and efficiency gains.

However, mainly as a consequence of EVN's internationalisation strategy, focused on expansion into developing Eastern and South-Eastern European markets, the share of regulated cash flows has decreased over time, with the company's growth strategy resulting in increasing exposure to unregulated activities and/or relatively less stable operating environments, thus negatively impacting the company's business risk assessment. Currently, EVN generates more than 30% of consolidated revenues and approximately 20% of EBITDA in Eastern and South-Eastern European countries.

In particular, EVN currently holds material electricity distribution and supply operations in Bulgaria and Macedonia which, whilst mainly focusing on regulated activities, present a higher level of risk related to the evolving and less stable nature of their regulatory frameworks. In relation to EVN's geographical expansion, Moody's notes the company's increasing involvement in Albania, where EVN is participating in two different joint ventures, including (i) the construction of three peak load hydro plants on the Devoll river in cooperation with the Norwegian Statkraft, and (ii) the construction of a run-of-river plant on the Drin river, for a cumulative investment of EUR160 million, in cooperation with Austrian utility Verbund. Moody's also notes that EVN has emerged as the best bidder in a tender process related to a 30-year concession for the distribution and supply of natural gas in Croatia.

Moody's scores EVN in single-A for contribution from low- or high risk activities, given that the credit positive impact of the proportion of regulated activities in EVN's business mix is somewhat offset by the riskier international activities in Eastern and South-Eastern Europe.

FACTOR 3: FINANCIAL POLICY

In recent years, EVN's management initiated a large operational diversification plan through an ambitious cross-selling strategy. This expanded the company's core business activities, historically concentrated in the energy segment, to include environmental services ranging from waste incineration and supply of drinking water to wastewater treatment. This diversification strategy has also resulted in a material expansion of the company's activities outside the domestic regional boundaries, in emerging markets, which present higher growth potential but also a higher risk profile.

Although EVN has a track record of prudent M&A policy, management has implemented a relatively aggressive acquisitive strategy over the past few years. Following the acquisition of a 67% shareholding in each of the two South-Eastern Bulgarian electricity distribution and supply companies in 2005, EVN now provides electricity services to approximately one-third of the country. The transaction was followed by the acquisition of the country's second-largest district heating plant. In 2006, EVN further expanded its presence in Eastern Europe through the acquisition of a 90% stake in the Macedonian electricity distribution and supply company ESMAD, providing electricity services to the whole country. In addition, over the past few years, EVN has entered into various project finance transactions in the drinking water, wastewater and waste incineration segments, mainly in Eastern and South-Eastern Europe. The recent acquisition of a stake in hydro generation assets on the Inn River confirms the company's acquisitive strategy.

Moody's believes that this strategy, whilst concentrated on activities with higher growth potential, has and will continue to materially increase EVN's exposure to developing countries characterised by relatively lower stability and will contribute to the progressive shift in EVN's business risk profile, given the current and projected contribution from those activities to the overall group's performance.

Despite its historically acquisitive strategy, EVN's management continues to be committed to a relatively strong financial profile, as indicated by the company's stated objective of maintaining a rating within the A-category. This strategy is also supported by a conservative dividend policy (around 35% - 40% payout ratio), aimed at achieving a balance between investments that support the long-term growth targets of the company and attractive shareholder returns.

Moody's scores EVN Baa for its financial policy, which is in line with the average score for this sub-factor seen in the rated European utilities universe.

FACTOR 4: FINANCIAL STRENGTH METRICS

As a result of its historically acquisitive strategy, coupled with increasing investments in core activities and international markets, EVN's gross financial debt increased significantly in recent years, from EUR741 million at the end of September 2003 to approximately EUR1.9 billion as at September 2010, leading to a weakening of the company's financial profile from historical strong levels.

Taking into account Moody's assessment of EVN's business risk profile, which reflects the growing importance of international operations, Moody's expects EVN to exhibit an FFO interest coverage ratio of 4.5-5.5x, FFO to Net Debt of 20-25% and RCF to Net Debt of 15-20% on a sustainable basis to support the current A3 rating. In Moody's view, the continuation of the company's capex programme over the period 2011-13 will continue to weigh on the company's financial profile, thus limiting financial flexibility at the current rating level.

In this context, Moody's notes the recent announcement related to the postponement of the commissioning of the coal-fired power plant in Duisburg-Walsum. EVN holds a 49% stake in the plant, with the remaining 51% owned by the German generator Steag. Whilst this stake is reflected in the company's accounts under the equity method, EVN provides a guarantee (until commissioning) for its portion of the debt, which is included in Moody's debt adjustments (approximately EUR294 million as of year end 2009/10). In addition to EVN's potential obligations associated with the debt repayments for the Duisburg-Walsum plant deriving from the delay in commissioning, Moody's notes that the magnitude of the additional repair/construction costs are unclear at this stage.

In Moody's view, the combination of the factors discussed above, as well as the recent acquisition of hydro assets, is likely to result in some negative pressure on EVN's credit metrics which, if permanent and not balanced by alternative measures, could potentially result in downward rating pressure.

Liquidity

EVN's liquidity profile is satisfactory. Primary sources of liquidity include the company's operating cash flow generation and cash and liquid securities balances, which were around EUR158 million as at March 2011, and EUR275 million held in liquid cash funds. Secondary sources include an undrawn EUR600 million revolving credit facility maturing in 2013. Together, these sources would provide sufficient funds to cover payments expected over the next 12 months for capital expenditure, debt repayments and dividends. Of the EUR1.9 billion of gross debt as of March 2011, approximately EUR308 million matures by March 2012.

At the same time, Moody's notes that EVN's fixed-asset investments in listed companies - such as Verbund - are not included in the net debt calculation as EVN continues to regard its Verbund stake as strategic.

Rating Outlook

The outlook associated with EVN's ratings is stable, reflecting Moody's expectation that EVN will exhibit a financial profile broadly in line with the ratio guidance for the A3 rating. However, Moody's cautions that EVN's financial flexibility at the current rating level is limited, leaving modest headroom to absorb any potential material impact of the delay in the commissioning of its Duisburg-Walsum plant and the effect of a volatile power price environment or regulatory/political risks in its international operations.

What Could Change the Rating - Up

An improved financial profile, supported by ratios of FFO / Net Debt and RCF / Net Debt in excess of 25% and 20%, respectively, could put upward pressure on the ratings. However, in light of EVN's sizeable investment programme over the period 2010-13 and the recent developments related to the acquisition of hydro assets and the postponement in the commissioning of the Duisburg-Walsum plant, Moody's does not envisage any upward rating pressure in the near term.

What Could Change the Rating - Down

On the basis of EVN's current business risk profile and strategy, downward rating pressure could develop if EVN's financial profile were to deteriorate permanently below the minimum parameters for the ratings, including FFO / Net Debt below 20% and RCF / Net Debt below 15%.

In addition, negative pressure on EVN's rating may develop in the context of a deterioration of the credit quality of the Province of Lower Austria and/or a reduction of the support assumptions currently incorporated in Moody's assessment.

Rating Factors

EVN AG

Global Unregulated Utilities	Aaa	Aa	A	Baa	Ba	B	Caa
Factor 1: Market Assessment, Scale and Competitive Position (25%)							
a) Size and scale			x				
b) Competitive position and market structure				x			
Factor 2: Cash Flow Predictability of Business Model (25%)							
a) Fuel strategy and mix				x			
b) Degree of integration & hedging strategy			x				
c) Capital requirements & operational performance					x		
d) Contribution from low/high risk businesses			x				
Factor 3: Financial Policy (10%)							
a) Financial policy				x			
Factor 4: Financial Strength Metrics (40%) [1]							
a) (FFO + Interest)/Interest				5.7x			
b) FFO / Net Debt				21.8%			
c) RCF / Net Debt				17.1%			
d) FCF / Net Debt					-1.9%		
Rating:							
a) Indicated BCA from Grid				Baa1			
b) Actual BCA Assigned				8 (Baa1)			

Government Related Issuer	Factor
a) Baseline Credit Assessment	8 (Baa1)
b) Supporter Rating	Aaa
c) Default Dependence	Moderate
d) Support	Moderate

[1] 3-year average

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