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# Summary:
# EVN AG

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## Summary:
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**Credit Rating:** A-/Negative/--

## Rationale

The rating on Austrian energy and environmental services company EVN AG reflects our view of its position as the main provider of electricity and energy-related services in Lower Austria, its large share of stable income and cash flow from regulated and lower risk domestic electricity and gas network activities, and its 51% ownership by the State of Lower Austria (AA+/Stable/A-1+).

We consider the ratings on EVN constrained by the company's significant and increasing exposure to higher risk energy markets in south-eastern Europe, where its competitive position and profitability are significantly weaker than in its domestic market. Furthermore, EVN has increased its debt following largely debt-financed acquisitions and capital expenditure in recent years. In our opinion, EVN's currently modest-scale but growing environmental project business in Russia and central and eastern Europe have a higher business risk than its core domestic energy-related activities.

Our rating in EVN further reflects our methodology for rating government-related entities (GREs). In our opinion, there is a "moderate" likelihood that the State of Lower Austria would provide timely and sufficient extraordinary support in the event of financial distress. We assess EVN's standalone credit profile at 'BBB+'.

### Key business and profitability developments

In the fiscal year ended Sept. 30, 2009, EVN's revenues increased by about 14% on the previous fiscal year. This was primarily because electricity and heat sales volumes, and to an extent pricing, were higher and because order intake in the environmental services segment increased. At the same time, however, expenses for electricity purchases and primary energy increased because EVN bought quantities at higher market prices than in previous periods, reflecting its short position in electricity generation compared with volumes sold. The cost of materials and services in the Environmental Services segment also increased in line with rises in the order intake. As a result, reported EBITDA increased by 3% to €373 million. Nevertheless, EVN's operating margin fell to about 14% in the fiscal year ended Sept. 30, 2009, compared with about 15% in the previous fiscal year.

During the first half of fiscal 2010 (ended March 31, 2010), EVN's revenues from electricity and heat increased on the same period of the previous year because the cold winter boosted electricity, gas, and heat volumes. Nevertheless, weather-related delays in EVN's project business offset this increase. Consequently, revenues for the 12 months to March 31, 2010, remained flat at about €2.7 billion on the previous period. EBITDA during the first half of fiscal 2010 increased by about 10% on a last-12-month (LTM) basis, and EVN's operating margin recovered to about 15%.

We expect generally adverse market conditions to continue over the short term. However, we believe a gradual and moderate economic recovery should positively affect electricity demand and benefit EVN over the next few years. In addition, we believe the current order intake and backlog should also enable EVN to increase its project-related revenue in the environmental services sector.

### Key cash flow and capital-structure developments

In our opinion, EVN's financial risk profile has weakened as a result of its higher financial leverage. We believe EVN's credit metrics could remain weak, owing to lower profitability at EVN's expanding operations in central and south-eastern Europe and due to ongoing high investment levels, which are likely to continue to weigh on EVN's cash flow-related credit measures in the coming years.

EVN generated negative free operating cash flow in fiscal 2009, largely through significant investments during the year, mainly in electricity and gas networks in Lower Austria, in its south-eastern European operations, and in the Environmental Services segment. As a result, adjusted debt increased to about €2.1 billion from €1.7 billion.

According to our calculations, EVN's funds from operations (FFO)-to-debt ratio was about 22%, debt to EBITDA was 5.3x, and debt to capital was about 40% as of fiscal year-end Sept. 30, 2009.

Cash flow from operations improved during the first half of the current fiscal year. However, free operating cash flow remained negative due to capital expenditure during the period and debt increased further.

We understand that EVN plans to make further substantial investments in its domestic and international operations, and has announced its intention to increase its dividend for the current fiscal year. Consequently, we don't expect discretionary cash flow to turn positive during the next two years, which in our view will restrict meaningful debt reduction over the next few years.

### Liquidity

We consider EVN's overall liquidity to be adequate. As of March 31, 2010, the company held a total of €278 million in cash and securities. According to management, the company also had access to an undrawn committed syndicated credit facility of €600 million, which matures in 2013.

We expect EVN's discretionary cash flow to remain negative over the next two years. However, scheduled debt amortizations in 2010 and 2011 (about €650 million) should either be refinanced or be covered by available cash and committed credit lines.

## Outlook

The negative outlook reflects our concerns regarding EVN's continuously high investment levels and the low profitability of its international operations, which could keep restricting the company's financial profile over the next few years.

We could consider a negative rating action if we see that EVN is unable to comfortably sustain an FFO-to-debt ratio of more than 20%. Rating downside could also stem from adverse changes in the company's business risk profile, possibly resulting from a higher proportion of income generated in countries we regard as higher risk, riskier business activities, a more aggressive financial policy, or higher financial leverage.

Conversely, we could revise the outlook to stable if we see that EVN is likely to comfortably maintain an FFO-to-debt ratio of more than 20%, assuming that we do not perceive a weakening of EVN's business risk profile.

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