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Summary:
EVN AG

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Summary:

EVN AG

Credit Rating: A-/Negative/--

Rationale

The rating on Austrian utility EVN AG reflects the predictable revenues that the company generates through its stable domestic monopoly network operations, which account for about 30% of earnings. It equally takes into account Standard & Poor's Ratings Services' view of the company's strong domestic market position as a supplier of electricity, gas, water, and heat, with a fairly supportive customer base. These strengths are offset by EVN's exposure to competition in the liberalized Austrian electricity and gas supply market, its short position in power generation, and some continued regulatory pressure on its monopoly network operations. EVN also has network activities in higher-risk countries such as Bulgaria and Macedonia, as well as an aggressive expansion strategy focusing on internal and external growth, particularly in environmental services and power generation and in Central and Eastern Europe.

Key business and profitability developments

First-quarter results (ended Dec. 31, 2008) for the current 2008/2009 fiscal year reflected the negative impact of the economic environment and mild weather. Reported EBITDA contracted 2.4% to €133 million due to higher prices paid for electricity purchases, raw materials, and personnel. The contraction was more pronounced at the net income level, with net profit falling by 29.3% to €55 million, primarily on the back of lower income from investments in associates.

We deem that EVN potentially faces higher operating risk in Macedonia following developments recently communicated by the company, although, at this stage, the situation appears uncertain and still developing. In April 2009, EVN informed the Macedonian government that it was contemplating initiating international arbitration in relation to various actions taken against the EVN group, which controls 90% of EVN Macedonia AD, the formerly state-owned sole domestic electricity distributor. In particular, according to EVN, court proceedings have been initiated against this subsidiary in relation to €93 million (excluding interest) in unpaid electricity bills dating back to 1995-2004, prior to the subsidiary's privatization. EVN maintains that such proceedings are against the share purchase agreement stipulated with the Republic of Macedonia, and is evaluating whether to start arbitration to protect its investments if the proceedings are not dropped. We will monitor the evolution of the situation to evaluate whether it could have an impact on EVN's rating.

Key cash flow and capital-structure developments

Reported net debt increased to €1,316 million as of Dec. 31, 2008, from €1,131 million at fiscal year-end Sept. 30, 2008. This growth resulted from a €167 million increase in working capital, which the decline in capital expenditures (to €89 million from €139 million over the same period) only partially compensated. However, we understand from EVN that the spike in working capital was only temporary and related to the closing date of the balance sheet; the company expects it to be absorbed during the current fiscal year.

Liquidity

We consider EVN's liquidity to be adequate. Since the beginning of January 2009, EVN has issued bonds for ¥12 billion (about €90 million), Swiss franc 250 million (about €165 million), and €58 million, which, together, more than cover the debt maturing in 2009 and 2010. EVN has also indicated that its €600 million bank facility, maturing in 2013, is currently fully available, and that cash and equivalents totaled €137 million as of March 31, 2009. Maturing debt amounts to €165 million in 2009 and €24 million in 2010.

We believe that EVN will likely be cash flow negative in the intermediate term in light of its planned investments, but will nevertheless be able to manage its funding needs with available liquidity. In addition, about half of planned investments are deferrable, according to the company.

Outlook

The negative outlook is based on our view that, given recent performance, EVN has only limited flexibility at the current rating level at a time when we consider its earnings and cash flow to be under pressure. We could lower the rating if financial performance weakens further in fiscal 2009 and we deem a recovery unlikely in fiscal 2010, thus preventing maintenance of funds from operations to debt of about 25% on a sustainable basis with a broadly unchanged level of business risk. We will also monitor how the company manages its investment plan in the current economic and financial environment. The rating does not anticipate material changes in business risk, acquisitions, or changes in financial (including dividend) policies. If unfavorable developments eventually affect EVN's Macedonian operations and overall business risk, we will evaluate the impact, if any, on EVN's rating, depending on our assessment of the extent of the deterioration of EVN's business and financial profile and any potential mitigating factors.

Conversely, we could revise the outlook to stable if we gain sufficient comfort about EVN's ability to maintain a credit profile consistent with the current ratings in the medium term. This ability would likely entail a recovery in operating performance and the pursuit of a less capital-intensive growth strategy.

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