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Research Update:

Austrian Utility EVN AG 'A-' Rating Affirmed; Outlook Remains Negative

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Overview

- The operating and financial performance of EVN AG, the leading integrated utility in the State of Lower Austria, has improved during the past year.
- We are affirming the 'A-' long-term rating on the company.
- The negative outlook reflects our view that EVN's credit metrics could weaken due to remaining political and economic uncertainties, especially in Southeast Europe and recently announced assets purchases.

Rating Action

On July 1, 2011, Standard & Poor's Ratings Services affirmed the 'A-' long-term corporate credit rating on Austrian utility company EVN AG. The outlook remains negative.

Rationale

The rating incorporates our view of the company's strength in regional electricity and gas distribution, its strong position as the leading utility in the prosperous State of Lower Austria (unsolicited AA+/Stable/A-1+), and high share of stable regulated income mainly from domestic power and gas network operations. We understand that EVN's strategy will in the future concentrate on stabilizing the portfolio of its operating businesses and the company's financial risk profile instead of international expansion, and that the focus of investments will be its core domestic operations.

We consider the credit strengths of EVN to be to an extent offset by its exposure to volatile power wholesale and commodities markets and higher risk energy markets in Southeast Europe, where, despite recent successes, the company is still facing considerable challenges. Its competitive position and profitability are significantly weaker in this region than in its domestic market in Austria. Furthermore, in our opinion EVN's financial risk profile remains weaker than its peer Austrian regional utilities, despite the positive development of the past year.

Given these continuing challenges in EVN's operating environment, and taking into account that the company's business risk profile is burdened by a higher share of revenue and income from higher risk activities than peers, we have revised our view of EVN's business risk profile to "satisfactory" from "strong". However, on the back of recent improvements in the company's financial performance, we now view its financial risk profile as "intermediate" instead of "significant".

EVN's key credit metrics improved during fiscal 2009-2010 mainly as a result of increased profitability and cash flow. These improvements continued in the first half of the current fiscal year (October 2010 to March 31, 2011). On a Standard & Poor's adjusted basis at the end of the fiscal year, the ratio of funds from operations (FFO) to debt increased to 23.6% compared with 21.2% in fiscal 2008-2009. The ratio of debt to EBITDA decreased to 5x (compared with 5.3x) and the EBITDA interest cover ratio improved to 4.7x (3.6x). As of March 31, 2011, EVN reported €158 million of cash and cash equivalents, €275 million in cash funds, and €1,896 million of short- and long-term financial liabilities.

The rating also reflects our methodology for rating government-related entities (GRES) and our opinion that there is a "moderate" likelihood that the State of Lower Austria would provide timely and sufficient extraordinary support in the event of financial distress. This is based on our assessment of EVN's:

- "Strong" link with the State of Lower Austria, based on Lower Austria's majority ownership of the company, which in our view is unlikely to be reduced over the next few years; and
- "Limited" role, notwithstanding EVN's provision of essential services in Lower Austria. This reflects how the company largely operates in a liberalized energy market and that many of its services could be provided by a private-sector company or another GRE.

We assess EVN's stand-alone credit profile (SACP) at 'bbb+'.

Liquidity

EVN's liquidity is strong, in our view. As of March 31, 2011, the company reported a total of €158 million in cash and cash equivalents, as well as a further €275 million in cash funds. In addition, it has access to a €600 million committed bank line maturing in September 2013, which is currently undrawn.

Over the next two years, we expect EVN's free operating cash flow and discretionary cash flow to be positive. As of March 31, 2011, the debt maturities for following two years totaled €279 million, according to the company. We expect EVN to be able to cover its liquidity needs from operating cash flow, cash on balance sheet, and available credit lines.

Additionally, we consider EVN's sizable stake in Austrian listed utility Verbund AG (A-/Stable/--) significantly enhances the company's financial flexibility.

Outlook

The negative outlook reflects our view that the rating on EVN could come under pressure if the company were unable to maintain a sustainable improvement in

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