STANDARD & POOR'S

INFRASTRUCTURE FINANCE

EVN AG Ratings Lowered To 'A' Following Acquisition In Macedonia; Outlook Stable

Primary Credit Analysts:
Ralf Etzelmueller
Frankfurt
(49) 69-33-999-123
ralf_etzelmueller@
standardandpoors.com

Secondary Credit Analyst:
Amrit Gescher
London
(44) 20-7176-3733
amrit_gescher@
standardandpoors.com

Additional Contact: Industrial Ratings Europe
CorporateFinanceEurope@
standardandpoors.com

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Credit Rating: A/Stable/--

Rationale

On March 20, 2006, Standard & Poor's Ratings Services lowered its long-term corporate credit rating on AustriA-based utility EVN AG (EVN) to 'A' from 'A+', reflecting the company's more-aggressive corporate acquisition strategy. The outlook is stable.

The rating action follows EVN's acquisition of the MacedoniA-based electricity company Elektrostopanstvo na Makedonija AD (ESM) for €225 million ($270 million) and €96 million in additional investment requirements. This transaction represents EVN's second credit-dilutive investment in a European transition economy within two years.

As the Republic of Macedonia (foreign currency BB+/Stable/B; local currency BBB-/Stable/A-3) is a transition economy, the acquisition, which is the second-largest in EVN's corporate history, will weaken EVN's business profile. Following the acquisition, more than one-half of EVN's electricity sales (in terawatt-hours) will come from two transition economies, Bulgaria and Macedonia.

Furthermore, Standard & Poor's expects EVN's debt and interest coverage ratios to weaken as a result of higher net debt. This would, however, be mitigated by EVN's expected proceeds in the amount of about €175 million from the sale of its stake in Energie AG Oberoesterreich. (A+/Stable/—) back to the State of Upper Austria (AAA/Stable/A-1+).

The ratings on EVN reflect the predictable revenues generated by its stable monopoly network operations, and its strong market position as a supplier of electricity, gas, water, and heat. This is supported by EVN's strategic joint ventures with other Austrian utilities, and its robust financial profile.

These strengths are offset by EVN's exposure to competition in the liberalized Austrian electricity and gas supply market; continued and more transparent regulatory pressure on its monopoly network operations; and a more aggressive corporate strategy focusing on growth by acquisitions and expansion—in particular in the lower rated Eastern European countries.

Despite the increased business risk, EVN continues to report sound financial figures. The group's cash flow after capital expenditures and before acquisitions (discretionary cash flow) for the fiscal year ended Sept. 30, 2005, was sound at €83 million, slightly above the previous year. Funds from operations (FFO) improved to €295 million from €244 million in 2004. At the same time, however, interest expenses increased to €49 million from €45 million in the previous year, and total debt increased to €1,036 million (compared with €1,018 million in 2004). FFO to interest cover improved to 7x (6.4x in 2004), owing to stronger cash flows, and FFO to total debt was 28% (24%). FFO to net debt decreased to 32%, from 35% in 2004, owing to higher net debt.

Total debt to total capital, excluding a net pension liability of approximately €155 million, dropped to 30% at Sept. 30, 2005, from 37% in 2004. Including pension obligations, however, this ratio rises to 32% (40% in 2004). The drop in leverage ratios is due to the significant increase in the company's equity reserves, which were fueled by the strong performance of Verbundgesellschaft (Oesterreichische Elektrizitaetswirtschafts Aktiengesellschaft) (A/Stable/—) in 2005, in which EVN holds 12.5%, reflecting a current market value of €1.4 billion.

Liquidity

EVN still has ample liquidity, with €261 million in cash and cash equivalents at Sept. 30, 2005. The company faces no significant debt maturities before 2008, when about €233 million will mature. Refinancing risk is, therefore, considered to be low. EVN has five outstanding bonds with a book value of about €695 million.

Outlook

The stable outlook reflects Standard & Poor's expectation that EVN's still robust financial profile will remain sustainable. The ratings assume that FFO to net debt will remain more than 30% in the medium term. Any weakening of this key ratio or a further weakening in EVN's business profile would be likely to put pressure on the ratings. Such pressure could result from changes in the market environment or as result of further material investments in higher-risk countries or activities.

EVN's Increasing Business Risk

Prior to the acquisition of ESM in Macedonia, EVN's business risk profile had already weakened as a result of the acquisition of two regional electricity distribution companies in Bulgaria in 2004. In addition, in April 2005, EVN increased its indirect stake in Rohoel-Aufsuchungs-AG (RAG; not rated) to 37.5% via an asset swap with German utility E.ON AG (AA-/Watch Neg/A-1+). RAG is the second-largest Austrian company in the oil and gas upstream business, with large storage capacities. We consider the upstream business to be riskier than the regulated utility business. RAG can, however, provide EVN with improved access to storage capacity.

Over the past five years, EVN has become a diversified multi-utility, with activities in electricity, gas, heat, water, wastewater, and waste incineration in Austria and Central and Eastern Europe (CEE), having formerly been predominantly a domestic utility with interests in electricity, gas, and heat. The group's water and waste activities are predominantly operated on a nonrecourse project-finance basis, but we consider these operations to be core and strategically important. We therefore fully factor them into our rating analysis. In 2005, about 24% of the group's consolidated EBIT came from CEE countries, which have generally lower sovereign ratings and higher economic and political risks than Austria.

Ratings List

	To	From
Corporate credit ratings		
	A/Stable/—	A+/Negative/—

NB: This list does not include all ratings affected.

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