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## EVN AG

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### Table Of Contents

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Major Rating Factors

Rationale

Outlook

Business Description

Business Risk Profile: Increasing Business Risk From Geographic  
Diversification

Financial Risk Profile: Robust Cash Flow Generation, A Diversified Debt  
Structure, And Strong Liquidity

# EVN AG

## Major Rating Factors

### Strengths:

- Distribution monopoly and very strong market position in electricity, gas, heat, waste incineration, and water supply in the State of Lower Austria
- Key member of a domestic joint venture, providing a shared trading and procurement platform
- Modest financial risk profile
- Minority interests in other utilities, which could be sold in the event of financial difficulty

### Weaknesses:

- Increasing exposure to higher risk transition economies due to a more aggressive acquisition strategy
- Planned expansion of generation fleet
- Exposure to increasing competition in the residential customer market
- Operates in a fully liberalized and competitive market
- Exposed to modest regulatory pressure on network tariffs

### Corporate Credit Rating

A/Negative/--

## Rationale

The ratings on Austria-based utility EVN AG reflect the predictable revenues it generates through its stable monopoly network operations and its strong market position as a supplier of electricity, gas, water, and heat. EVN also has strategic joint ventures with other Austrian utilities and a modest financial risk profile.

These strengths are offset by the company's exposure to competition in the liberalized Austrian electricity and gas supply market, and regulatory pressure on its monopoly network operations. EVN also has an aggressive corporate strategy focused on internal and external growth, particularly in lower-rated Eastern European countries, and an increasingly ambitious target to enlarge its generation fleet.

EVN reported sound financial results for the fiscal year ended Sept. 30, 2007, mainly fueled by the increased scope of its consolidation, which offset mild weather conditions in 2006-2007. Funds from operations (FFO) improved to €453 million in fiscal 2007, from €423 million the previous year, thanks to greater consolidation and higher investment grants. At the same time, however, adjusted interest expense increased further to €98 million, from €81 million the previous year, reflecting a less favorable interest environment. Adjusted debt declined to €1.23 billion, from €1.28 billion, primarily due to higher cash and near-cash investments. The increase in FFO did not offset the increase in interest expenses. Therefore, FFO to interest coverage fell to 5.4x (6.0x in 2006), but FFO to debt improved to 37% from 33%.

Total debt to capital declined slightly in fiscal 2007 to 29%, from 32% the previous year. This low leverage ratio indicates the ongoing increase in EVN's equity reserves, buoyed by the strong share price performance of Verbundgesellschaft (Oesterreichische Elektrizitaetswirtschafts Aktiengesellschaft) (Verbund; A/Stable/--), in which EVN holds a 12.8% stake worth about €1.7 billion at the end of January 2008.

## Liquidity

EVN has a very strong liquidity position with more than €390 million in cash and cash equivalents, and €600 million available under an undrawn committed bank line as of Dec. 31, 2007. The company faces about €240 million in debt maturities in 2008, mostly as a result of two bonds due for repayment. Thanks to EVN's comfortable cash position and the credit facility in place, Standard & Poor's Ratings Services considers refinancing risk to be very low.

## Outlook

The negative outlook reflects our expectation that EVN's intention to enter the electricity generation business in Albania will further weaken its business risk profile. We expect the project to cost several hundred million euros, invested over several years.

## Business Description

EVN, Austria's second-largest regional electricity and gas distribution utility, serves about 800,000 electricity and 280,000 gas customers in the State of Lower Austria (AA+/Stable/A-1+), 1.5 million electricity customers in Bulgaria, and 720,000 electricity customers in Macedonia. In 2006-2007, it derived about 66% of revenues and almost 90% of EBIT from Austria, with the balance from Central and Eastern Europe (CEE). The energy division accounted for 85% of revenues, with the balance made up of environmental services.

As one of few partly privatized Austrian utilities, EVN is 51% owned by Lower Austria. Although Germany-based EnBW Energie Baden-Wuerttemberg AG (A-/Stable/A-2) increased its stake to about 35%, Austrian and state laws still prohibit privatization of regional utilities such as EVN. This acts as a legal barrier preventing foreign utilities from buying majority stakes in Austrian electricity utilities. We do not expect this policy to change in the medium term, nor did we factor state support into the ratings.

## Business Risk Profile: Increasing Business Risk From Geographic Diversification

EVN's still strong business risk profile is underpinned by the predictable revenues generated by its network operations and the company's strong local market position as a supplier of various utility services. These strengths are partly offset by its exposure to competition in the liberalized Austrian market, regulatory pressure on network operations, and in particular, by its growth-focused strategy in Eastern Europe.

### Strategy: Aggressive growth plan to become a pan-European multiutility

EVN previously operated mainly as a domestic utility, providing electricity, gas, and heat, but has become a diversified pan-European multiutility, with activities in electricity, gas, heat, water, waste water, and waste incineration in Austria and CEE countries. The group's water and waste activities are mainly operated through nonrecourse project finance.

EVN's business risk profile weakened following its acquisition of two regional electricity distribution companies in Bulgaria in 2005 and weakened further with its purchase of electricity monopoly distributor Elektrostopanstvo na Makedonija AD (ESM AD) in Macedonia in 2006. In addition, in late January 2008 EVN was named preferred bidder for the construction of three hydropower plants in Albania with a capacity of about 400 megawatts (MW).

EVN has indicated that these projects are of a long-term nature and are expected to start after 2015.

**Regulation: More predictable and less aggressive than in the past**

The regulatory pressure on EVN is crucial to its business risk profile. From a rating perspective, network tariffs remain fundamental to the financial strength of a distribution company because they represent a significant portion--close to 50%--of the end-consumer electricity price, excluding taxes and other levies.

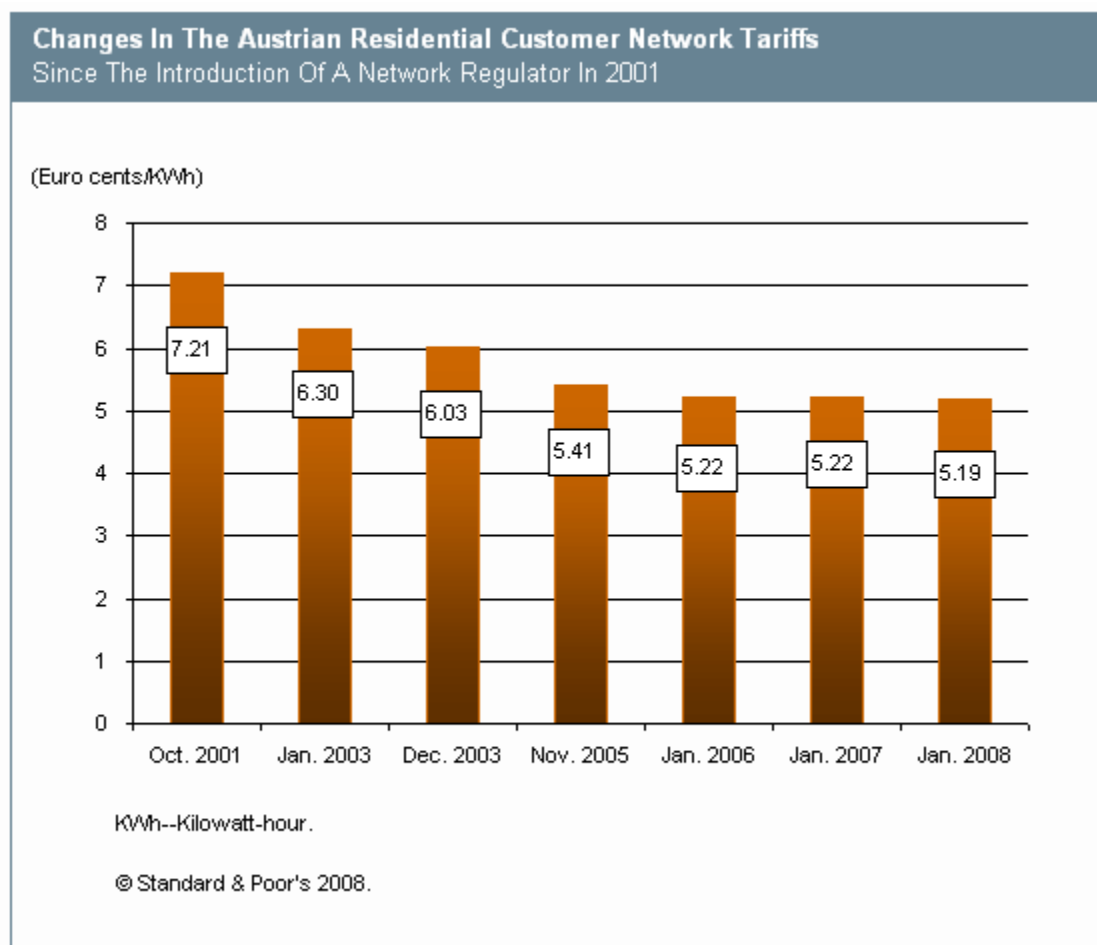
In early 2006, the Austrian energy regulator Energie-Control GmbH introduced an incentive-based regulatory system, which runs until 2010. The tariff calculation incorporates discounts for an annual productivity factor of 1.95% and a maximum efficiency factor discount of 3.5%. We note that this incentive-based system has led, across the board, to much lower network tariff cuts than the previous regulatory system, which is positive for rated utilities.

EVN's low-voltage network tariffs will remain stable for 2008, whereas the Austrian average network tariff adjustment for the year was negative 0.6%. The company expects its efficiency discount to remain low to moderate over the next two years because it covers a challenging service area that is less concentrated and less densely populated, and because of its strong business performance.

We expect EVN's future tariff cuts under the current regime to be much lower than those in the early years of regulation. Since regulation began in 2001, the company's residential network tariffs have been reduced by 19%, which is lower than the average tariff cuts suffered by its Austrian peers. The regime again allowed some utilities small tariff increases in January 2008.

The incentive-based regulation for the gas business was launched in February 2008. We also expect this regime to be more transparent and predictable than the old system.

Chart 1

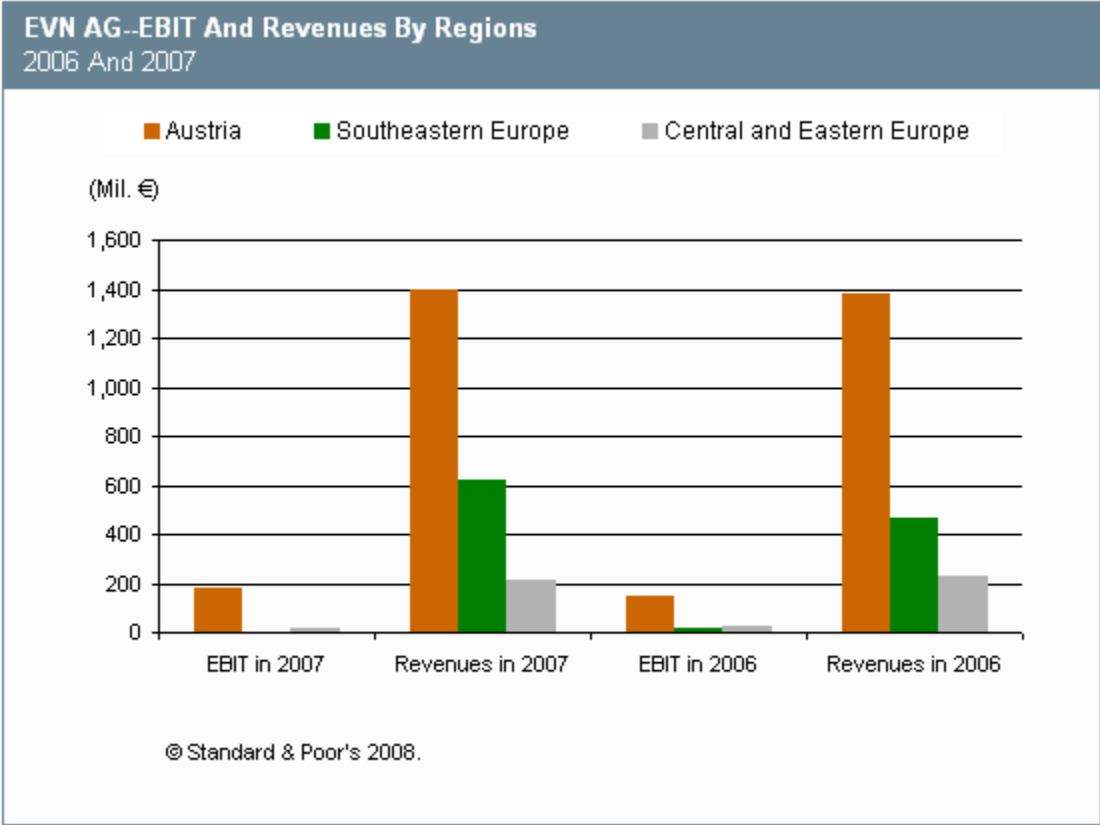


### Markets: Mixed service areas put pressure on business risk profile

Lower Austria is a favorable service area for EVN. It is Austria's largest state and the second most populous after Vienna. EVN has an above-average share of residential customers compared with other Austrian utilities, which we consider positive because this customer segment is the most profitable and normally the least likely to switch suppliers.

The Austrian economy is strong and has been growing faster than the Eurozone average. Bulgaria and Macedonia, however, present the opportunities and challenges typical of transition economies, although Bulgaria is more advanced in its development. These countries are expected to expand by more than 5.0% and 4.0%, respectively, per year. EVN's confirmed status as preferred bidder for three hydropower plants in Albania underlines its more aggressive expansion strategy. We consider this negative for the company's business risk profile because it would make EVN more dependent on revenues from transition economies.

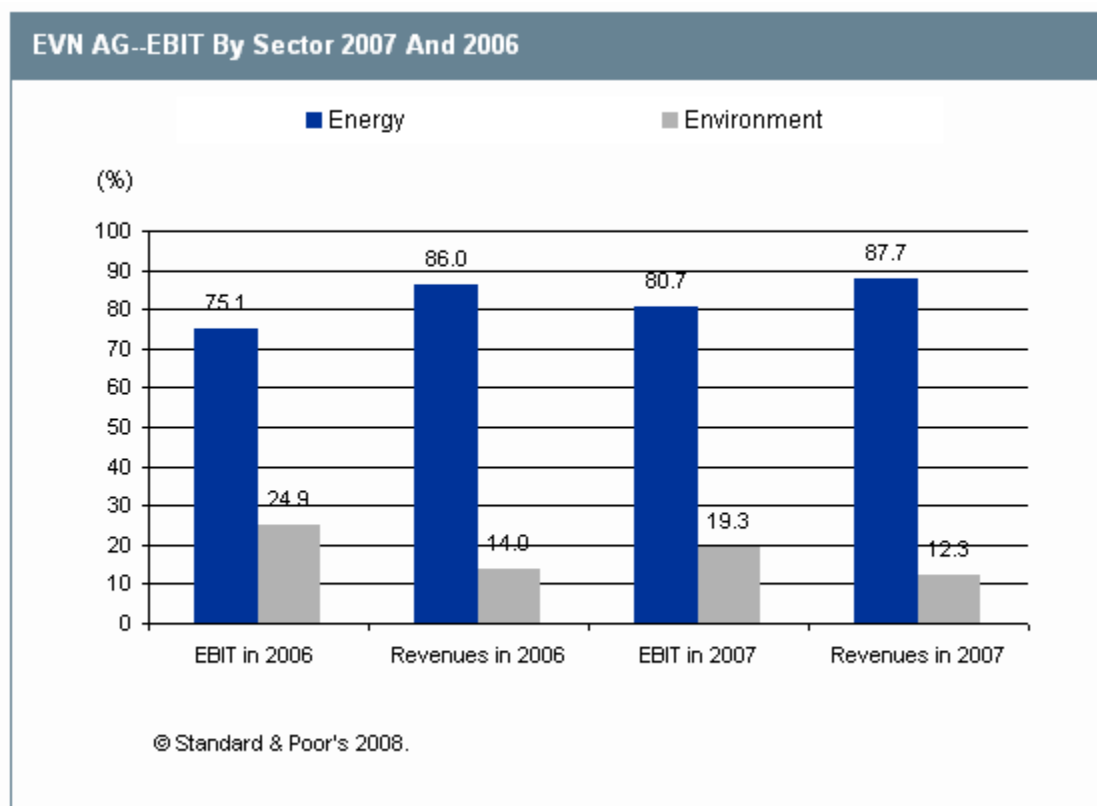
Chart 2



**Operations: Two main divisions, energy, and environmental services**

EVN's activities are organized in two main divisions: energy and environmental services. Energy includes generation, supply, networks, and distribution and supply for southeastern Europe. Environmental services include the segments waste, water, and waste water.

Chart 3



## Energy

### *Generation and supply concentrated in thermal plants.*

Most of EVN's 1,702 MW generation capacity is concentrated in three multifired thermal plants (1,382 MW). Its portfolio is complemented by hydro assets (194 MW), wind power (116 MW), and biomass (10 MW). The company's generation portfolio is weaker than that of other rated regional Austrian utilities because it is weighted toward relatively expensive base load, with very little hydro generation, and lacks strategic pumped-storage hydro plants that can service peak load hours.

In 2007, EVN generated 19% of the total electricity volume provided to end customers (29% in 2006). Excluding the Bulgarian and Macedonian subsidiaries (which do not have generation capacity), however, this figure was 56% (71% in 2006). This is approximately in line with the proportion of internal generation of two of its Austrian peers, Energie AG (53% in 2006) and KELAG AG (50% in 2006).

The short-term position, however, exposes EVN to the volatile wholesale power market. If energy prices increase, it might not be able to pass on higher procurement costs to end customers, especially in the more regulated transition economies. EVN is therefore keen to increase its own generation capacity and has targeted a minimum 40% of electricity supply from its own operations.

To bolster its generation portfolio, EVN (in a joint venture with Steag AG) is building a 790 MW hard-coal power plant in Duisburg-Walsum in Germany, which is expected to start operating in 2010. EVN has a 49% stake in the project and will purchase a corresponding amount of power. The investment is expected to amount to €820 million,

of which 25% will be equity financed and 75% funded through nonrecourse project finance debt.

EVN operates in the Central European wholesale market that includes Germany, Austria, and Switzerland. Wholesale prices have been fairly high since 2005 compared with those at the beginning of the decade, primarily reflecting increased expenses for fuel procurement, increases owing to the January 2005 introduction of carbon dioxide emissions trading, and reduced overcapacity. Spot prices in 2007 were clearly below the levels seen in 2005 and 2006, but both spot and forward prices are expected to remain high in the next three years.

***Focus on improving profitability in Southeastern Europe.***

EVN aims to upgrade the profitability of its southeastern European subsidiaries by improving network efficiency and cutting network losses, corporate reorganization, receivables collection, and customer service. It also aims to enlarge its presence in energy and environmental services.

The company's Bulgarian subsidiaries serve about one third of the country's electricity customers, while ESM AD is Macedonia's monopoly electricity distributor. The Bulgarian energy market has been officially liberalized since mid-2007. However, many long-term procurement contracts between energy producers and the dominant domestic utility Natsionalna Elektrieska Kompania EAD remain in force. This prevents free market activity because the supply of noncontracted electricity is fairly low. In addition, the Bulgarian regulator focuses on security of supply, which further reduces the available electricity on the spot market. Electricity tariffs in Bulgaria are about 50% lower than those in Western Europe.

The electricity market in Macedonia is based on a single-buyer model, meaning that the operator of the national transmission system purchases and resells the electricity. The regulator supervises electricity supply and network tariffs.

**Capacity enhancement in Environmental Services under way**

The Environmental Services division encompasses regional supply of drinking water and a waste incineration plant in Lower Austria (Durnrohr). It also includes projects in drinking water, waste water treatment, purification, and waste incineration in CEE.

EVN intends to increase the capacity of the Durnrohr waste incineration plant to 500,000 tons in 2009. Outside Austria, the drinking water facility and the waste incineration plant in Moscow were completed, and the central waste water treatment plant in Zagreb became fully operational during fiscal 2007. In general, EVN's international projects are financed on a nonrecourse basis within long-term build, own, operate, and transfer frameworks with the relevant municipalities.

**Other investments**

EVN's most important equity investments are a 12.8% stake in Verbund, a 37.5% stake in RAG AG, and a 69.0% stake in Burgenland Holding AG (the second-largest shareholder in utilities Burgenländische Elektrizitätswirtschafts-AG and Burgenländische Erdgasversorgungs-AG). The company considers all three investments to be strategic, and they are not earmarked for sale.

**Competitive position/Profitability: Monopoly in distribution, low competition elsewhere**

EVN still holds a strong competitive position, owing to its natural monopoly distribution network business, which is exposed to moderate regulatory pressure.

In the electricity supply sector, competition for residential customers used to be rather moderate and Austrian

residential customer churn (turnover) rates have been fairly low. This, however, has changed somewhat following Verbund's entrance into the retail market in the second half of 2005. Verbund's electricity supply prices are aggressive and difficult for other suppliers to match. It claims to have gained about 130,000 retail customers, about 3% of all Austrian retail customers--since entering the market. This trend is credit negative for the rated regional utilities because their supply margins are likely to come under pressure.

We don't expect the current profit margins in the supply business to attract many more players, owing to Verbund's aggressive pricing, high marketing costs for establishing a brand, and retail customers' unwillingness to switch providers.

EVN's domestic joint ventures, such as EnergieAllianz and Econgas, aim to help the company gain critical mass and to counter possible competition from foreign rivals. On a European scale, however, these alliances are small.

There is less competition in the gas sector, where churn rates are even lower, owing to the strong market positions of the incumbents and the limited number of suppliers.

## Financial Risk Profile: Robust Cash Flow Generation, A Diversified Debt Structure, And Strong Liquidity

EVN's overall financial risk profile is still modest. The company, however, wants to expand, and is actively seeking investment opportunities beyond Austria because domestic growth opportunities are limited.

Its debt structure is diversified, with substantial short-term debt due in 2008, but we consider refinancing risk to be extremely low given the company's access to long-term bank facilities and its strong liquidity.

### Accounting: Moderate on-balance-sheet pension provisions for defined benefit obligations

EVN prepares its annual accounts according to International Financial Reporting Standards. Accounting features include moderate on-balance-sheet pension provisions for defined benefit obligations, which is common among German and Austrian companies.

Standard & Poor's has adjusted EVN's reported figures for fiscal 2007, and from this period has included a guarantee of up to €300 million (relating to the construction of the Walsum plant) to adjusted debt on an incremental basis. The portion for 2007 is €70.7 million (see table 1).

**Table 1**

EVN AG--Reconciliation Of Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. €)*						
--Fiscal year ended Sept. 30, 2007--						
	Debt	Shareholders' equity	Operating income (before D&A)	Interest expense	Cash flow from operations	Capital expenditures
Reported amounts	1,419.8	2,788.0	350.6	75.8	407.3	273.3
<b>Standard &amp; Poor's adjustments</b>						
Postretirement benefit obligations	210.8	(5.8)	15.1	15.1	1.9	--
Additional items included in debt	70.7	--	--	--	--	--

**Table 1**

<b>EVN AG--Reconciliation Of Reported Amounts With Standard &amp; Poor's Adjusted Amounts (Mil. €)*(cont.)</b>						
Surplus cash and near cash investments	(471.9)	--	--	--	--	--
Capitalized interest	--	--	--	7.4	(7.4)	(7.4)
Reclassification of nonoperating income (expenses)	--	--	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	51.7	--
Minority interests	--	226.7	--	--	--	--
Total adjustments	(190.3)	220.9	15.1	22.5	46.1	(7.4)
<b>Standard &amp; Poor's adjusted amounts</b>						
	<b>Debt</b>	<b>Equity</b>	<b>EBITDA</b>	<b>Interest expense</b>	<b>Funds from operations</b>	<b>Capital expenditures</b>
Adjusted	1,229.5	3,008.9	365.7	98.4	453.4	265.9

\*EVN AG's reported amounts are taken from the company's financial statements but might include adjustments made by data providers or reclassifications made by Standard & Poor's analysts. Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

### Corporate governance/Risk tolerance/Financial policies

EVN has an above-average tolerance for risk and a more aggressive financial policy compared with its Austrian peers. Its strategy exposes it to a degree of event risk. However, the company manages the rating requirements in the context of its overall strategy, and would prefer to stay in the 'A' category.

EVN's dividend policy used to be conservative, but has become more aggressive. Given its shareholder structure (51% State of Lower Austria, less than 15% floating capital, and EnBW with about 35%), the company appears to be under less pressure from shareholders than other majority-investor-owned utilities.

### Cash flow adequacy: Strong, despite increased business risk

Despite increased business risk, EVN reported satisfactory financial statistics for fiscal 2007.

FFO improved slightly to €453 million. However, at the same time the adjusted interest expense increased to €98 million, from €81 million the previous year, and adjusted debt decreased to €1.23 billion from €1.27 billion, owing to a higher cash position. FFO interest coverage fell to 5.4% because of higher interest expenses, while FFO to debt improved to 37% from 33%.

Given the increasing business risk caused by the company's expansion plans, and its intention to enlarge the generation fleet, we expect it to report an FFO interest cover of about 6x and FFO to debt of more than 30% to defend the rating. EVN has achieved these ratios in the past and we expect them to continue to do so over the medium term.

### Capital structure/Asset protection: Diversified maturity structure, with low refinancing risk

Overall, EVN's capital structure is conservative. There are significant debt maturities in 2008, when about €300 million are up for repayment. However, we consider refinancing risk to be low, given the company's ample cash position and its headroom under existing bank facilities.

EVN has five outstanding bonds with a book value of about €665 million, two of which are due in 2008. None of these bonds contain rating triggers or minimum rating requirements, which further reduces the company's low liquidity risk significantly. In addition, EVN has largely hedged its currency risk in Japanese yen and Swiss franc. Exposure to interest rate risk is moderate because about 50% of gross debt is either at a fixed rate or hedged.

Contingent liabilities consist mainly of those derived from warranties and uncovered risks relating to environmental hazards, which we do not consider to be material.

We did not apply structural subordination because the group's parent company, EVN AG, is an industrial holding that owns operating assets (generation and district heating), and centralizes its debt management. The parent company also holds substantial liquidity and equity investments, in particular, its stake in Verbund.

**Table 2**

<b>EVN AG--Peer Comparison*</b>					
	<b>EVN AG</b>	<b>Energie AG Oberoesterreich</b>	<b>EWE AG</b>	<b>RheinEnergie</b>	<b>Mainova</b>
Corporate credit rating as of March 7, 2008	A/Negative/--	A+/Negative/--	A-/Negative/--	--/--/--	--/--/--
<b>(Mil. €)</b>	<b>--Fiscal year ended Sept. 30, 2007--</b>		<b>--Fiscal year ended Dec. 31, 2006--</b>		
Revenues	2,279	1,228	6,513	3,507	1,669
Net income from continuing operations	227	115	184	155	49
Funds from operations (FFO)	453	317	787	282	146
Capital expenditure	266	282	448	47	99
Debt	1,230	590	2,522	0	173
Equity	3,009	1,219	1,050	643	799
Debt and equity	4,238	1,809	3,571	643	971
<b>Adjusted ratios</b>					
EBIT interest coverage (x)	3.8	4.1	3.6	16.2	6.7
FFO interest coverage (x)	5.4	7.4	7.1	19.5	9.1
FFO/debt (%)	36.9	53.8	31.2	N.M.	84.7
Discretionary cash flow/debt (%)	3.5	2.1	(1.7)	N.M.	57.2
Net cash flow /capital expenditure (%)	135.8	106.2	162.1	181.5	106.2
Debt/total capital (%)	29.0	32.6	70.6	0.0	17.8

\*Fully adjusted (including postretirement obligations). Excess cash and investments netted against debt. N.M.--Not meaningful.

**Table 3**

<b>EVN AG--Financial Summary*</b>			
	<b>--Fiscal year ended Sept. 30--</b>		
<b>(Mil. €)</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
Revenues	2,279	2,112	1,651
Net income from continuing operations	227	222	144
Funds from operations (FFO)	453	423	291
Capital expenditure	266	241	123
Debt	1,230	1,277	1,022
Equity	3,009	2,748	2,274
Debt and equity	4,238	4,025	3,296

Table 3

EVN AG--Financial Summary*(cont.)			
<b>Adjusted ratios</b>			
EBIT interest coverage (x)	3.8	4.3	3.3
FFO interest coverage (x)	5.4	6.0	5.0
FFO/debt (%)	36.9	33.1	28.5
Discretionary cash flow/debt (%)	3.5	6.0	8.4
Net cash flow /capital expenditure (%)	135.8	144.7	205.8
Debt/debt and equity (%)	29.0	31.7	31.0

\*Fully adjusted (including postretirement obligations). Excess cash and investments netted against debt.

Ratings Detail (As Of March 7, 2008)*	
<b>EVN AG</b>	
Corporate Credit Rating	A/Negative/--
Senior Unsecured	A
<b>Corporate Credit Ratings History</b>	
29-Feb-2008	A/Negative/--
20-Mar-2006	A/Stable/--
03-Feb-2006	A+/Negative/--
09-Aug-2004	A+/Stable/--
21-Jan-2004	AA-/Negative/--
<b>Business Risk Profile</b>	<b>1 2 3 4 5 6 7 8 9 10</b>
<b>Financial Risk Profile</b>	Modest
<b>Debt Maturities</b>	
2008: €240 mil.	
2009: €125 mil.	
Beyond 2012: €284 mil.	

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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