Energie AG Oberoesterreich

Credit Rating:
A+/Negative/—

Primary Credit Analyst:
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: Infrastructure
Finance Ratings Europe
InfrastructureEurope@
standardandpoors.com

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Rationale

The ratings on Austria-based Energie AG Oberoesterreich (Energie AG) reflect the company's regional electricity distribution monopoly, its strong position as the leading electricity supplier and infrastructure service provider in the prosperous State of Upper Austria (AAA/Stable/A-1+), and its robust financial profile. These credit strengths are offset by: regulatory pressure on Energie AG's electricity distribution network tariffs; intensified competition after Austria-based Verbundgesellschaft (Oesterreichische Elektrizitaetswirtschafts Aktiengesellschaft; A/Stable/—) entered into the electricity retail market; and the company's announced long-term investment strategy in thermal generation facilities, which entails the development of a 400 MW gas plant expected to come online in 2008/2009. However, management intends to develop this plant as a joint venture and the company does not plan to develop any further larger generation project until 2009.

Energie AG derives about 25% of revenues and operating results from the waste and water management business. Standard & Poor's Ratings Services considers this negative for credit quality, as this business carries a moderately higher operating risk than the regulated electricity distribution business. However, a substantial share of this business is characterized by long-term contracts with the public sector, therefore mitigating the business risk.

Energie AG group changed its company structure in October 2006, creating a holding company and 12 operating entities. Nevertheless, it still keeps the bulk of its assets at the holding company level, which mitigates the issue of structural subordination of the parent company creditors in relation to the creditors of the operating subsidiaries.

Energie AG is now owned by the State of Upper Austria (93.75%)—which repurchased shares from EVN AG (A/Stable/—) and Vienna Utilities—and Linz AG (6.25%). However, Upper Austria is looking for a strategic investor to participate in Energie AG.

Energie AG's financial performance improved again in 2006 on the already strong previous year. Funds from operations (FFO) to debt and FFO to interest remained robust at 34% and 6.6x, respectively, which is in line with peers.

Energie AG, has undertaken significant cross-border lease transactions (CBLs), covering about 35% of its fixed assets. CBLs can reduce recovery prospects for creditors in the event of a bankruptcy, as the equity-strip value of the CBLs could potentially rank as priority liabilities relative to Energie AG's rated bonds. Nevertheless, the likely amount of the potential priority obligation is not sufficient to require any notching down of Energie AG's outstanding bond issues.

Liquidity

Energie AG's liquidity is adequate, with about EUR45 million in cash and EUR210 million in investment funds, which could be divested at short notice if needed. Covenants relating to the CBLs could result in liquidity pressures if the rating on Energie AG were to be lowered, as they require the company to provide letters of credit (LoC) covering part of the equity-strip value. However, we consider the possible impact of the LoC on the liquidity as rather low.

Outlook

The negative outlook reflects Standard & Poor's expectation that Energie AG's financial profile is likely to be negatively affected by its envisaged long-term investment strategy in the generation sector. Debt-financed investments and acquisitions in other higher risk activities could also result in a rating action. The ratings assume that FFO to debt will stay above 30% over the medium term. Any weakening of this key ratio or in Energie AG's business profile would be likely to put pressure on the ratings.

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