Alpiq Group Financial Review

Use of new company names

During the reporting year, most of the companies in the Group were renamed to incorporate the Alpiq brand name. At the end of December 2009, the two principal companies, Olten-based Aare-Tessin Ltd. for Electricity (Atel) and Lausanne-based Energie Ouest Suisse (EOS) SA, also changed their names to Alpiq Ltd. and Alpiq Suisse Ltd. respectively. The financial review and following financial statements of the Alpiq Group and Alpiq Holding Ltd. include some information relating to past events concerning these principal companies. Where meaningful, the former company names have been used.

In the list of subsidiaries and investments, all significant companies in the Alpiq Group are shown under their new names.

Preliminary notes

The Alpiq Group was newly formed in early February 2009 through the combination of Atel and EOS, together with EDF's purchase rights in Emosson. This means that 2009 is the first financial year in which the new Group is reporting consolidated results. To nevertheless allow an assessment of the Group's and Energy segment's operating performance during the year, consolidated financial statements have been prepared for 2008 as if the businesses had already been combined in February 2008 (pro forma financial statements). For this purpose, Atel's consolidated figures for 2008 and the figures of EOS and Emosson from February 2008 have been used, taking into account the consolidation effects arising in connection with the business combinations. Both for 2009 and in the pro forma financial statements for the previous year, amortisation of the EOS / Emosson assets, as revalued at the date of the combination, and the effects of the transaction with EOS are included in operating expenses and net finance costs respectively.

The formal financial statements for the year ended 31 December 2009 prepared in accordance with IFRS accounting principles are presented on pages 67 ff. All prior year comparatives shown represent the figures published by the former Atel Group excluding EOS and Emosson.

Alpiq Group on a comparable basis (pro forma financial statements for 2008)

Consolidated income statement (condensed)

CHF million	Pro forma for 2008	Statement for 2009
Net revenue	**16,013**	**14,822**
Other income	390	312
Total revenue and other income	**16,403**	**15,134**
Operating expenses before depreciation and amortisation	– 14,776	– 13,589
EBITDA	**1,627**	**1,545**
Depreciation and amortisation	– 480	– 481
EBIT	**1,147**	**1,064**
Net finance costs	– 215	– 164
Profit before income tax	**932**	**900**
Income tax expense	– 200	– 224
Group profit for the year	**732**	**676**

Consolidated statement of financial position (condensed)

Assets

CHF million	Pro forma at 31 Dec 2008	Statement at 31 Dec 2009
Property, plant and equipment	5,289	5,732
Intangible assets	2,577	2,585
Financial assets, incl. deferred tax	5,893	5,985
Non-current assets	**13,759**	**14,302**
Cash and cash equivalents, incl. term deposits and current asset investments	1,433	1,792
Other current assets	3,881	4,005
Current assets	**5,314**	**5,797**
Total assets	**19,073**	**20,099**

Equity and liabilities

CHF million	Pro forma at 31 Dec 2008	Statement at 31 Dec 2009
Equity attributable to equity holders of Alpiq Holding	7,139	7,720
Minority interests	207	210
Total equity	**7,346**	**7,930**
Non-current provisions, incl. deferred tax	2,126	2,111
Financial liabilities	5,320	5,519
Other liabilities	4,281	4,539
Total liabilities	**11,727**	**12,169**
Total equity and liabilities	**19,073**	**20,099**

The following review of results relates to performance in 2009 as compared with the pro forma financial statements for the previous year.

Alpiq Group results of operations

In financial terms, Alpiq's first year of operations was impacted by three major factors: the integration of the combined Atel, EOS and EDF (Swiss) operations, the global financial and economic crisis, and the rulings and requirements of the Swiss Federal Electricity Commission (ElCom). While the merger of the businesses of Atel, EOS and EDF (Swiss) will generate enormous potential and opportunities in the medium term, we had to contend with considerable integration costs in the short term. With the financial and economic crisis, and the ensuing negative effects on energy demand, energy prices and market liquidity, our business development was constrained and adversely affected in a variety of ways. And lastly, the ElCom interventions and directives had the effect of reducing Alpiq's earnings by well over CHF 50 million in comparison with previous years.

Against this backdrop, the Alpiq Group generated consolidated revenue of CHF 14.8 billion, a year-on-year decrease of 7.4 %. With EBITDA at CHF 1,545 million and EBIT at CHF 1,064 million, operating profits were down on the comparative prior year levels (CHF 1,627 million and CHF 1,147 million), but nonetheless came in ahead of expectations considering the tense economic climate.

This performance was primarily driven by the positive contributions from energy trading and sales in Switzerland, Western Europe and the southern part of Central Europe. Added to this, power generation in Switzerland and Central Europe outpaced expectations. Another boost came from the investment returns on the decommissioning and nuclear waste disposal funds for nuclear power stations. Conversely, as mentioned above, our results were negatively impacted by the integration costs, declining demand for energy, significantly lower prices and margins, reduced market liquidity and the costs of ancillary services. The Energy Services segment managed to offset the effects of the adverse economic conditions in part by working off the high backlog of orders on hand but, despite its good performance, was unable to match the record figures posted a year earlier.

On a like-for-like basis, excluding the effects of exchange rate movements and changes in the consolidated Group during the year, EBITDA was down by 4.1 % and EBIT by 5.9 %.

Net finance costs improved by 23.7 % year on year. Exchange rates of the principal currencies for Alpiq remained constant on balance over 2009, following the negative impact of the strong Swiss franc on foreign currency translation in the previous year. In contrast, the efforts of various European governments to extend the tax base left their mark, resulting in a 12 % increase in tax expense despite lower pre-tax profit.

Coming in at CHF 676 million, Alpiq's reported Group profit for the year was CHF 56 million or 7.7 % lower than a year earlier. On a like-for-like basis, excluding changes in the consolidated Group and the effects of foreign currency translation, the decline was CHF 42 million or 5.7 %.

Group financial position

The Alpiq Group's total assets grew by approximately CHF 1 billion compared with the pro forma statement of financial position for the previous year. Capital expenditure on ongoing power generation projects and the integration of the Romanian sales company acquired in 2009 resulted in an increase of approximately CHF 0.54 billion in non-current assets. Other current assets were up by CHF 0.1 billion year on year due to slightly higher receivables. Following the successful placement of publicly offered bond issues amounting to CHF 1.2 billion, the Group's liquid assets rose to CHF 1.78 billion despite the repayment of more than CHF 0.85 billion in borrowings and bridge loans, as well as the above-mentioned capital expenditure on projects and acquisitions. This low-cost funding is being used to finance more capital investments and reduce outstanding borrowings. The ratio of net debt to EBITDA remained stable at 2.4 times compared with the pro forma figures for 2008, while the equity ratio increased slightly from the pro forma level of 38.5 % to 39.5 %.

Energy segment

Market conditions

During 2009, the European energy markets were subject to sharp fluctuations, with market conditions affected by the global financial and economic crisis. Demand for energy dropped in virtually all European countries. Electricity and commodity prices plummeted at the beginning of the year, then stabilised at a slightly higher level in the second quarter and subsequently moved mostly sideways. A perennial issue on the supply side was the reduced availability of nuclear power in France. Prices were underpinned by France's high electricity imports as well as the cold weather early and late in the year. In the second half of August, the high temperatures drove electricity prices up to over EUR 100 per MWh, especially around midday. Otherwise, there were few surprising and extreme price swings.

Many macroeconomic indicators currently show that the situation is bottoming out, with the first signs of economic stabilisation emerging. Nevertheless, a sustainable recovery will be sluggish for the time being, particularly in industrialised countries, since many government stimulus programmes are coming to an end and unemployment remains high. Added to that, subdued private consumption and fears of national bankruptcy are fuelling doubts about the sustainability of a fast economic rebound.

Alongside these economic developments, the reporting period was characterised by changes in the regulatory framework at European and Swiss level. In Switzerland, the Electricity Supply Act (StromVG) and Electricity Supply Ordinance (StromVV) now enacted and in force were implemented operationally with effect from 1 January 2009. Under the tightened regulatory requirements and the first rulings by the regulator, ElCom, Swiss power stations with a capacity of 50 MW or more have to bear a substantial portion of the increased costs of ancillary services. For 2009, this imposed a cost burden of way over CHF 50 million on Alpiq's generation facilities, only little of which could be recouped through additional business opportunities.

In Europe, the EU Council of Ministers adopted new energy directives and regulations primarily designed to provide the necessary legal framework to make full market liberalisation a reality. This is presenting new challenges for Switzerland and its bilateral negotiations.

Results of operations

The Energy segment generated consolidated revenue of CHF 12.8 billion for 2009, a decline of approximately CHF 1 billion or 8 % year on year. Although the intensified sales activities brought a 4 % increase in the consolidated sales volume to 135.2 TWh, revenue was impacted by the reduced liquidity in the energy markets, significantly lower European wholesale prices, regulatory stumbling blocks and adverse foreign currency movements. Operating profit (EBIT) reached CHF 1,003 million, virtually matching the year-earlier level of CHF 1,013 million. The excellent hydroelectric conditions in Switzerland, high availability of generation facilities in Central Europe and the successful activities of the Power Asset Trading and Optimisation units enhanced operating performance. The sales margins achieved by various market units also contributed to the stable results. Furthermore, unlike in the previous year, positive investment returns were generated on the nuclear decommissioning and waste disposal funds, which are recognised in the annual costs for the Gösgen and Leibstadt nuclear power stations. Conversely, the results were considerably weighed down by the mandatory charges to be paid to swissgrid for ancillary services in Switzerland from 1 January 2009, coupled with an exceptional loss arising from the insolvency of a sales partner in Central Europe and lower income from minority-owned companies in Italy.

Performance of the units

Operations in Switzerland were significantly strengthened by the merger. The business division made major progress and recorded positive earnings performance, driven in particular by combining the power generation units under one management and control. In its first year of joint operations, the Optimisation unit already benefited from the enlarged generation portfolio and made an encouraging contribution to results. Swiss supply and sales operations felt the negative economic climate. As expected, this led to lower sales levels both in wholesale business and in distribution across North-Western Switzerland. In contrast, the volume of sales to end customer supply partners in the French-speaking part of Switzerland were considerably up year on year.

Alpiq's power generation capacity in Switzerland has increased considerably since the generation portfolios of Atel and EOS were combined with the purchase rights associated with EDF's interest in Emosson and since the Cleuson-Dixence storage power station came back into operation in January 2010. The potential output now totals some 3,800 MW or an average of around 13,100 GWh per annum, representing about 20 % of Switzerland's generation capacity. The average costs of the combined generation portfolio are relatively low and stable, while the high proportion of storage facilities allows the generation facilities to be operated very flexibly. Having combined the portfolio management and optimisation, the Group was able to generate the first synergies and is all set to unleash substantial further synergies over the years ahead.

Alpiq Grid Ltd. Gösgen and Alpiq Grid Ltd Lausanne, the transmission network companies that are still managed separately, focused primarily on implementing the capital investment projects to assure trouble-free operation of the national transmission systems. As required by law, the responsibility for operating the high-voltage network was transferred to the national grid operator at the beginning of the year without any notable problems. Furthermore, measures were taken to ensure sustained, reliable and low-cost service operation after ownership of the transmission network is transferred to swissgrid.

The Trading & Services business division gained sustainable momentum from the merger between Atel and EOS, while filling the job vacancies in Olten again in spring 2009 and building up additional expertise. Operationally, the financial and economic crisis led to a decrease in the number of trading partners and to precautionary restrictions on trading and credit risk limits, which reduced the proprietary trading opportunities at times. The first quarter of 2009 saw prices in the electricity and commodity markets plummet. With shrewd positioning, both Power Asset Trading and Power Proprietary Trading profited from these movements. Despite low demand, electricity prices rallied during the next quarter, again having a positive impact on generation-related trading. As the markets then largely moved sideways, some of the gains were lost in the third quarter. Even though the spot, forward and futures prices fell in the final quarter, both Power Proprietary Trading and Power Asset Trading again generated more gains. The positive results were buoyed by the systematic drive to capitalise on short-term price spikes in neighbouring markets. Trading in CO_2 certificates also performed well and increased steadily. New business units were successfully established for Multi Commodities & Fuel Management and for Origination & Environmental Markets. Alpiq Eurotrade S.à.r.l., Luxembourg, a new trading company (holding a so-called MiFID licence) set up in the European Union, started operating successfully in 2009, already acquiring numerous orders and conducting a substantial volume of trades on the European energy exchanges.

In the business division for Western Europe, Market Italy once again delivered an encouraging contribution to earnings although demand dropped in the wake of the economic meltdown and energy prices tumbled. However, revenue generated locally was noticeably down on the previous year due to the plunge in market prices for electricity, added to which the sales volumes declined because of the focus on markets with higher margins and the effect of risk-oriented customer selection. Operations in the balancing energy market repeated their successful performance, albeit with lower margins than a year earlier due to regulatory changes and reduced consumption. In this region, trading in green certificates also generated a steady contribution to earnings once again.

The power generation units in Italy had to contend with difficult general conditions. With the spark spreads driven down by the price slump, operations were reduced and energy generation cut back. This was compounded by the decrease in industrial customers' demand for electricity and steam.

Market Europe West, which includes the Spanish and French markets, posted solid results in the reporting period, growing revenue despite a marked drop in prices. This increase was fuelled in particular by the expansion of sales business in Spain. The newly acquired Madrid-based Hispaelec Energia S.A.U., a sales company already well established in the market, was integrated at the end of 2009 and will help to drive further expansion from 2010. Encouragingly, the successful positioning in the local sales market in France enabled the sales figures there to be maintained at the year-earlier level, with earnings even improving slightly, although industrial customers' demand for energy declined considerably.

The Market Nordic unit fell short of the targets. This unsatisfactory performance was due to low prices, weak trading performance and reduced portfolio services. With the strategic and human resources measures put in place during the reporting period, the unit expects to see a positive trend and a noticeable improvement in earnings in the short to medium term.

The business division for Central Europe saw the markets heavily hit by the economic crisis, especially in the first six months of 2009. The strained economic situation brought a marked decline in demand for electricity, particularly in industry, which in turn triggered a fall in prices. The adverse effect of the lower electricity prices was largely offset by the high proportion of medium- and long-term contracts in the overall portfolio. While electricity prices picked up somewhat in the second half of 2009, this did not have a significant impact on margins.

Despite the economic crisis, the division generated substantial growth in overall revenue, fuelled by a significant upturn in delivery volumes in wholesale and distribution business. Operations in the Market Central Europe North region benefited from high market liquidity and price volatility, coupled with high volumes in local wholesale business in Poland. However, performance was negatively impacted by unfavourable forward price movements. The Market Central Europe South region outpaced expectations despite the difficult market environment, with results driven by the expanded sales activities and the stable conditions in regional wholesale business. An additional boost came from the regional portfolio optimisation and the successful enlargement of the trading portfolio in Romania.

In Germany, both the sales volume and revenue were maintained at the previous year's level despite reduced demand for electricity and lower market prices. In particular, this was the result of continued expansion of sales, growth in portfolio services and the high proportion of yearly contracts on favourable terms.

The power generation facilities in Central Europe also delivered positive results. With its excellent capacity utilisation, the Kladno power station complex outperformed expectations. Despite reduced output, the Csepel power stations achieved stable results, underpinned by high availability, favourable delivery contracts and tight cost management. With their good operating performance, the Central European generation facilities managed to fully offset the negative fall-out from the economic crisis, compensating in particular for the lower industrial demand for heat and power. During the second half of 2009, the modernised Spreetal gas-fired combined cycle power station began generating electricity in Germany. However, its start-up was negatively impacted by the high gas prices and low sales prices.

Energy Services segment

Market conditions

In 2009, the Energy Services segment experienced mixed market conditions in the different regions and business areas. Its Swiss operations were far less affected by the economic downturn than activities in the markets across the rest of Europe, especially in Germany and Italy.

In Switzerland, building services enjoyed satisfactory demand overall, with prices only coming under heavy pressure in urban centres and for large-scale projects. The first signs of declining demand became evident in the second half of the year, translating into a deterioration in contract pricing quality. The markets for transport technology remained stable, underpinned by continuous capital spending by the Swiss public sector.

Conditions in the markets for industrial and power plant engineering in Germany and neighbouring countries were largely favourable due to the longer-term horizon in facilities construction. While demand for power generation capacities remained high, further growth was impeded by general investment uncertainty fuelled by the licensing problems in Germany and projects postponed by customers. Developments in the markets for energy supply technology were unsatisfactory. The regulators' pressure on grid charges, German network owners' sales plans and, again, the licensing problems had a negative impact on capital spending in spite of the technological needs. A steep drop in prices was seen in particular in the area of transmission and distribution systems.

Results of operations

In 2009, the Energy Services segment generated revenue of approximately CHF 2.1 billion, a year-on-year decline of about 5 %. The Swiss Alpiq InTec Group (AIT) grew revenue by a satisfactory 5 %, while the volume of revenue in the German Alpiq Anlagentechnik Group (AAT) shrank by 6 % in local currency. As expected, the segment's consolidated operating profit (EBIT) was down year on year, dropping by 24 % to CHF 101 million. This decrease is mainly due to the cyclical downturn in demand in Germany and to the some CHF 20 million in exceptional items recognised in profit for the previous year.

Performance of the units

In 2009, the AIT Group increased revenue to CHF 807 million. The 5 % growth was driven by the robust business environment in Switzerland and the acquisitions during the first half of 2009, particularly in Northern Italy.

Despite the difficult environment, the AIT Group improved margins by implementing measures to improve efficiency in project handling. The Building Services (BS) business continued to enjoy high order intake as construction activity in Switzerland remained strong, but even here the prices for new contracts deteriorated substantially due to the economic climate and heightened competition. Negative effects, coupled with margin erosion, are expected in future periods. An installation and plumbing company with strong regional roots was acquired in Verona to strengthen the market position in Northern Italy. Margins remained stable in the Transport Technology (TT) business, which was only slightly affected by the economic downturn as a result of public spending.

The AAT Group's revenue was down 6 % year on year to EUR 875 million, with much of the decline being due to the deeper economic crisis seen in Germany. The drop in revenue was softened by the large backlog of orders from the previous year.

Overall, the AAT Group's results for 2009 are satisfactory. So far, the Industrial and Power Plant Engineering (IPPE) business has proved to be resilient to the crisis, bolstered by the constant demand for generation capacities. Order intake rose by 8 % in 2009, resulting in an order book of more than EUR 1 billion at the reporting date. While this business field generated stable earnings at a high level, the weak economy brought a marked contraction and lower margins in industrial operations. With many energy supply utilities holding back on capital spending, the Energy Supply Technology (EST) business saw a marked decrease in demand in the area of power distribution and transmission networks, which consequently weighed on margins and volumes. To counteract this, the EST business was extended with a targeted entry into electrical installations for large power stations.

Outlook

In the medium term, the merger between Atel and EOS to form Alpiq will generate additional business and growth opportunities for the company's Energy segment, which will already make significant contributions to the results for 2010. The Energy Services segment has attractive order books that will again ensure a positive performance. Nevertheless, 2010 will be another very demanding year for Alpiq, with continued and, in some cases, mounting pressure on prices and margins. In the first two months of 2010 alone, the relevant spot prices dropped by around 20 % compared with last year's period, while the longer-term forward prices gave up about 10 % in the same time frame. A recovery in demand and market liquidity is only expected to have an impact on Alpiq's business towards the end of 2010. With uncertainty still surrounding the regulatory environment, that will remain challenging. Added to that, the continued implementation of the integration process will again tie up funds and resources during 2010, albeit to a lesser extent than in 2009. Against this backdrop, the company expects to post another slight decline in revenue for 2010 with earnings on a par with 2009.