Iberdrola SA

Utilities – Energy/Integrated

BERENBERG
PARTNERSHIP SINCE 1590

M&A fear recedes, 20% total return

4 March 2015

BUY

Current price	Price target
EUR5.96	EUR7.00

03/03/2015 Madrid Close

Market cap (EURm)	38,082
Reuters	IBE.MC
Bloomberg	IBE SM

Changes made in this note

Rating: Buy (no change)
Price target: EUR7.00 (no change)

Estimates changes

	2014		2015E		2016E	
	old	Δ %	old	Δ %	old	Δ %
EBITDA	6,839	1.8	6,849	1.8	7,128	8.3
EBIT	3,856	2.2	3,866	4.5	4,149	11.6
EPS	0.38	-4.7	0.36	-3.1	0.40	1.8

Source: Berenberg estimates

Share data

Shares outstanding (m)	6,388
Enterprise value (EURm)	64,882
Daily trading volume	43,009,200

- **In a nutshell:** The UIL merger removes the fear of further M&A and, in fact, is a reasonable deal in itself. Future growth is likely to be focused on organic capex. Listing the US business should prove beneficial, both because US valuations are strong and doing so will provide future optionality on the 81.5% stake. We have updated our model for 2014 results, the merger and the small disposals in Brazil. Our numbers have not changed significantly. However, the group trades at a c15% discount to the sector's P/E 2016-18 and is delivering a 10% higher dividend yield. Its DPS CAGR of 11% is more than double that of the sector's 5%. Furthermore, the group will have a more-stable business mix. To us, Iberdrola offers 20% total return over the next 12 months. We retain our Buy recommendation.
- **Iberian forwards are depressed:** Despite vast over-supply, we expect Iberian power prices to rally: commodities are key. Although we see coal recovering somewhat in 2017, the bigger driver is likely to be carbon. Carbon has taken a step closer to rallying following the European Environment Committee's (ENVI) market reform proposals on 24 February. The next step is to reach agreement between the European Commission, Parliament and member states on a legal text so as to enact the Market Stability Reserve (MSR; we have discussed this extensively in previous reports). If carbon rallied to €15/tonne this year instead of in 2017, as we assume, then our EPS forecasts would be 9% and 13% above consensus for 2016 and 2017 respectively.
- **The UIL merger makes sense:** We expect Iberdrola to complete its merger with Connecticut-based utility UIL by December 2015. This will pool Iberdrola's US assets with UIL's (good geographical proximity), creating Iberdrola USA. UIL's shareholders will own 18.5% of the combined entity and receive $597m in cash (a 20% premium to the recent UIL share price). Iberdrola USA will be NYSE listed. This provides future optionality should Iberdrola wish, or need, to sell down. Iberdrola's valuation should also be boosted by 20% (see page 17). The company will have a more-stable business mix as networks and renewables will increase from 51% of the business to 55%, while generation and supply will shrink from 33% to 27%.
- **The acquisition box is now ticked, reducing M&A fears:** Now that the acquisition box has been ticked, we believe future expansion will be focused on organic capex in the north east of the US (ie regulated) and long-term power plant agreements in Mexico (ie defined returns).
- **Catalysts to drive the shares:** EU enactment of carbon MSR; the November 2015 UN Climate Change conference; renewable project announcements; share buybacks to match the scrip dividend uptake; the UK general election in May 2015; and the UK Competition and Markets Authority investigation (provisional findings expected this May, full report due in November 2015).

Y/E 31.12., EURm	2013	2014	2015E	2016E	2017E
EBITDA	6,757	6,965	6,971	7,720	8,224
EBIT	2,219	3,941	4,041	4,632	5,140
EPS	0.41	0.36	0.35	0.41	0.47
DPS	0.27	0.27	0.27	0.29	0.33
FCF per share	0.4	0.5	0.3	0.4	0.5
Y/E net debt (net cash)	25,265	25,233	24,530	24,306	23,322
EBITDA Growth	-12.5%	3.1%	0.1%	10.7%	6.5%
EPS Growth	-10.9%	-12.2%	-2.3%	15.8%	15.9%
DPS Growth	-10.9%	0.0%	0.0%	5.6%	15.9%
ROCE	2.8%	4.9%	5.0%	5.7%	6.3%
EV/EBITDA	9.7x	9.4x	9.3x	8.4x	7.7x
P/E	14.5x	16.6x	16.9x	14.6x	12.6x
Dividend Yield	4.5%	4.5%	4.5%	4.8%	5.5%
FCF Yield	7.3%	9.0%	5.3%	6.7%	7.7%

Source: Company data, Berenberg

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BUY

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Current price	Price target
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Market cap (EURm)	38,082
EV (EURm)	64,882
Trading volume	43,009,200
Free float	81.4%

Non-institutional shareholders

Qatar Holdings (8.3%)
ACS (6.2%)

Share performance

High 52 weeks	EUR6.18
Low 52 weeks	EUR4.79

Business description

Iberdrola generates, distributes, trades and markets electricity in the UK, US, Spain, Portugal and Latin America. The company specialises in clean energy and specifically wind power.

Performance relative to

	SXXP	SX6P
1mth	-6.0%	-1.5%
3mth	-9.0%	2.3%
12mth	10.7%	15.3%

Investment thesis

- Superior DPS growth to the sector average from 2016 fuelled by earnings from all divisions.
- Generation leads the pack with higher power prices from 2017, reflecting our bullish views on carbon this year and next, as well as coal (though not till 2017). The UK CMA review will have a modestly negative impact in 2016.
- Renewables should deliver growth on the back of capacity additions, primarily in the UK and US.
- Networks are also set to continue delivering their relatively stable cash flow and earnings growth.
- The balance sheet is set to improve so that, by 2017, the net debt/EBITDA should be below 3.0x from 3.6x at end 2014.
- The UIL merger increases earnings stability and boosts Iberdrola's valuation.
- Our valuation is based on a blend of metrics: a DCF sum-of-the-parts, a dividend discount model and a target P/E and yield.

Profit and loss summary

EURm	2012	2013	2014	2015E	2016E
Revenues	34,201	31,077	30,032	29,963	32,353
EBITDA	7,726	6,757	6,965	6,971	7,720
EBITA	4,377	2,219	3,941	4,041	4,632
EBIT	4,377	2,219	3,941	4,041	4,632
Associates contribution	-188	205	135	115	115
Net interest	1,224	1,278	1,122	1,096	1,083
Tax	172	-1,467	837	765	916
Minorities	28	31	38	48	147
Net income adj.	2,765	2,572	2,327	2,247	2,602
EPS reported	0.46	0.41	0.36	0.35	0.41
EPS adjusted	0.46	0.41	0.36	0.35	0.41
Year end shares	6,138	6,240	6,388	6,388	6,388
Average shares	6,138	6,240	6,388	6,388	6,388
DPS	0.30	0.27	0.27	0.27	0.29

Cash flow summary

EURm	2012	2013	2014	2015E	2016E
Net income	2,389	2,572	2,327	2,296	2,749
Depreciation	3,350	4,537	3,024	2,933	2,936
Working capital changes	-305	-673	202	-1	49
Other non-cash items	1,546	-631	1,248	0	0
Operating cash flow	6,980	5,805	6,800	5,227	5,733
Capex	-3,896	-3,092	-3,363	-3,200	-3,200
FCFE	3,083	2,714	3,437	2,027	2,533
Acquisitions, disposals	-319	-312	-299	442	-533
Other investment CF	-807	-795	-1,310	0	0
Dividends paid	-178	-184	-187	-1,766	-1,777
Buybacks, issuance	-127	-370	-748	0	0
Change in net debt	953	-952	474	703	223
Net debt	30,324	25,265	25,233	24,530	24,306
FCF per share	0.50	0.43	0.54	0.32	0.40

Growth and margins

	2012	2013	2014	2015E	2016E
Revenue growth	8.1%	-9.1%	-3.4%	-0.2%	8.0%
EBITDA growth	1.0%	-12.5%	3.1%	0.1%	10.7%
EBIT growth	-2.8%	-49.3%	77.6%	2.5%	14.6%
EPS adj growth	-4.6%	-10.9%	-12.2%	-2.3%	15.8%
FCF growth	49.1%	-12.0%	26.7%	-41.0%	25.0%
EBITDA margin	22.6%	21.7%	23.2%	23.3%	23.9%
EBIT margin	12.8%	7.1%	13.1%	13.5%	14.3%
Net income margin	8.1%	8.3%	7.7%	7.5%	8.0%
FCF margin	9.0%	8.7%	11.4%	6.8%	7.8%

Key ratios

	2012	2013	2014	2015E	2016E
Net debt / equity	89.0%	71.6%	70.5%	67.5%	65.2%
Net debt / EBITDA	3.9x	3.7x	3.6x	3.5x	3.1x
Avg cost of debt	3.9%	4.6%	4.4%	4.4%	4.4%
Tax rate	5.8%	-129.1%	26.1%	25.0%	25.0%
Interest cover	3.6x	1.7x	3.5x	3.7x	4.3x
Payout ratio	65.9%	65.9%	75.0%	76.7%	70.0%
ROCE	5.3%	2.8%	4.9%	5.0%	5.7%
Capex / sales	11.4%	9.9%	11.2%	10.7%	9.9%
Capex / depreciation	116.3%	68.1%	111.2%	109.1%	109.0%

Valuation metrics

	2012	2013	2014	2015E	2016E
P / adjusted EPS	13.0x	14.5x	16.6x	16.9x	14.6x
P / book value	1.1x	1.1x	1.1x	1.0x	1.0x
FCF yield	8.4%	7.3%	9.0%	5.3%	6.7%
Dividend yield	5.1%	4.5%	4.5%	4.5%	4.8%
EV / sales	1.9x	2.1x	2.2x	2.2x	2.0x
EV / EBITDA	8.6x	9.7x	9.4x	9.3x	8.4x
EV / EBIT	15.1x	29.4x	16.6x	16.1x	14.0x
EV / FCF	21.5x	24.0x	19.1x	32.0x	25.5x
EV / cap. employed	0.8x	0.8x	0.8x	0.8x	0.8x

Key risks to our investment thesis

- Power prices continue to fall, most likely because coal continues to decline. We do believe that the current coal price renders most coal plants economically unviable. We are more confident about our carbon forecast. But, should that not materialise, the downside is more limited than for other generators.
- Political pressure to cut UK consumer bills.
- Negative outcome from the CMA investigation: provisional findings May/June 2015; full report November/December 2015.
- Reduction in renewables capacity growth.

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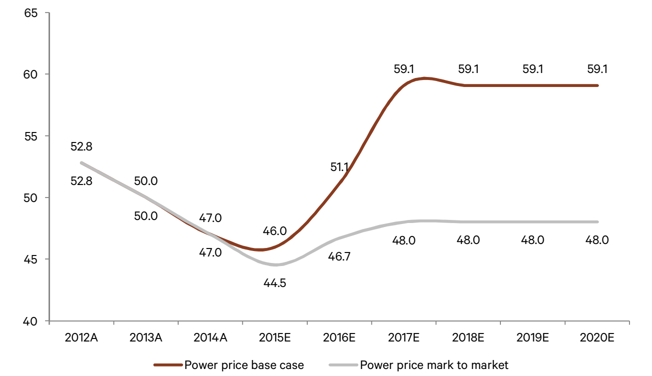
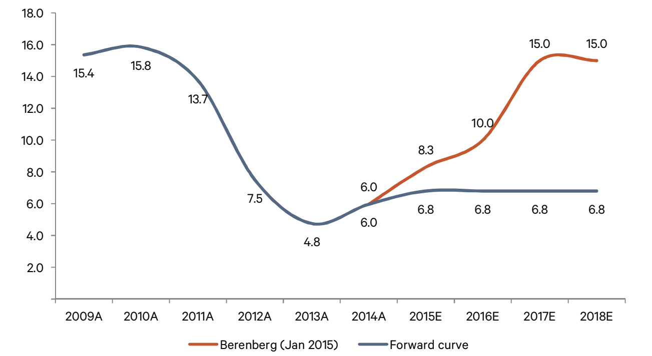
Iberdrola SA – investment thesis in pictures

Chart 1: We expect Iberian power prices to rally above the forward curves (€/MWh)



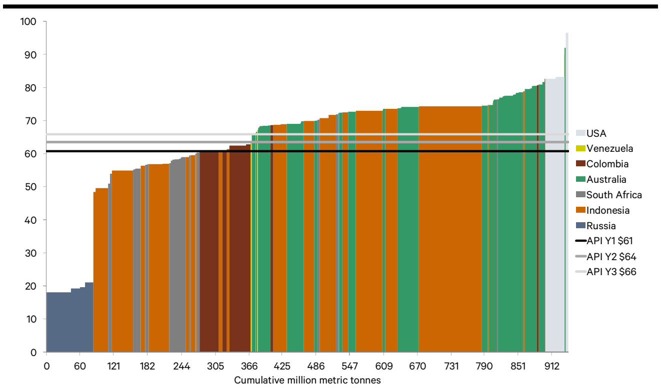
Source: Bloomberg, Berenberg estimates

Chart 2: Carbon is the key power price driver (€/tonne)



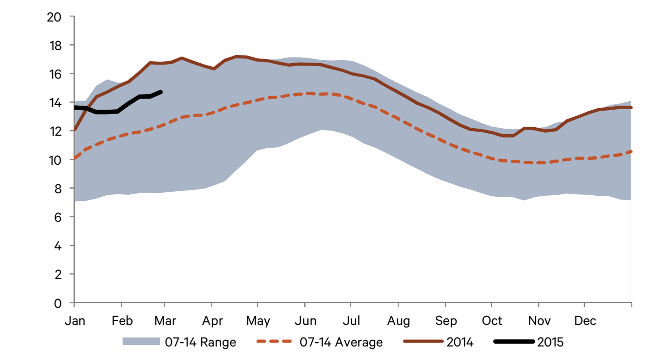
Source: Berenberg estimates

Chart 3: Coal forward prices are below plant marginal costs ($/tonne)



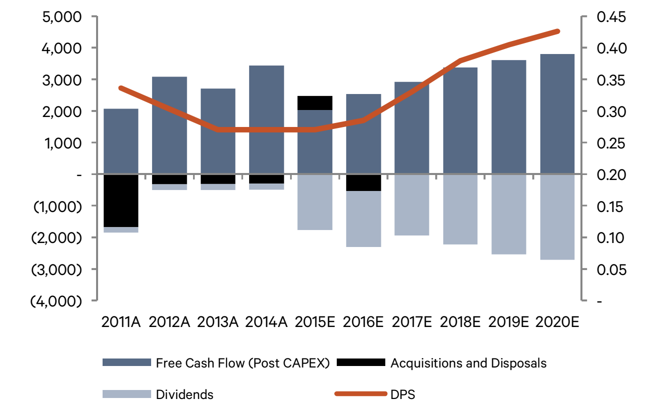
Source: Berenberg estimates

Chart 4: Spanish hydro output is below last year, but continues to be above the average for 2007-14



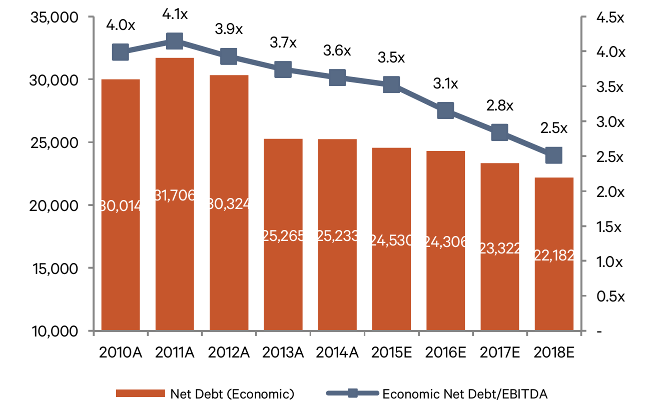
Source: Berenberg estimates using three-year forward DPS CAGR

Chart 5: FCF covers a growing dividend



Source: Berenberg estimates

Chart 6: Net debt/EBITDA falls significantly through to 2018



Source: Berenberg estimates

Iberdrola SA – investment thesis

What's new: We show that the impact of listing Iberdrola USA could result in an uplift of as much as 20% for Iberdrola Spain's shares. We have updated our Iberdrola model for two factors: the UIL merger (from 2016) and 2014 results.

Two-minute summary: The UIL merger removes the fear of further M&A and, in fact, is a reasonable deal in itself. Future growth is likely to be focused on organic capex. Listing the US business should prove beneficial, both because US valuations are strong and doing so will provide future optionality on the 81.5% stake. Iberdrola trades at a c15% discount to the sector's P/E 2016-18 and is delivering a 10% higher dividend yield. Its DPS CAGR of 11% is more than double that of the sector's 5%. Furthermore, the group will have a more-stable business mix. To us, Iberdrola offers 20% total return over the next 12 months. We retain our Buy recommendation.

Key investment point one: power price upside

- Iberian power prices are set to rise. A +/-€5/MWh move in the power price affects EPS by c4-6%.
- Iberia is substantially oversupplied and 2015 hydro conditions are currently above the average for 2007-14.
- Commodities are, therefore, the key drivers of the power price. We continue to be carbon bulls. Coal should also recover, though not until 2017.

Key investment point two: dividend sustainable with above sector growth

- We expect a DPS CAGR of 11% for 2015-17
- Payout ratio of 70% comfortably maintained as Iberdrola is cash flow positive after capex and dividends
- Cheap on yield/DPS CAGR versus the sector – also cheap on PE/EPS CAGR

Key investment point three: M&A: the big one is out of the way

- The UIL merger is a sensible deal
- Iberdrola USA could provide up to 20% upside to Iberdrola

Key investment point four: an improving financial position

- Net debt/EBITDA should fall from 3.6x in 2014 to 2.5x by 2018
- Most of this should be driven by an increase in EBITDA
- Net debt should also fall

Other key issues

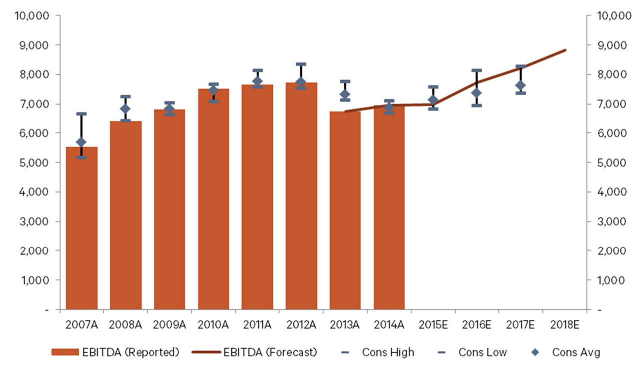
- UK distribution review (RIIO-ED1)
- Brazilian government offers support amid continuation of drought

Changes to numbers; Berenberg versus consensus

We have updated our forecasts for 2014 results, the merger and the small disposals in Brazil. Our numbers have not changed significantly: EPS -3%/+2%/+2% for 2015/16/17. We are +9% versus consensus EPS for 2017, reflecting our bullish view on carbon, coal and power prices.

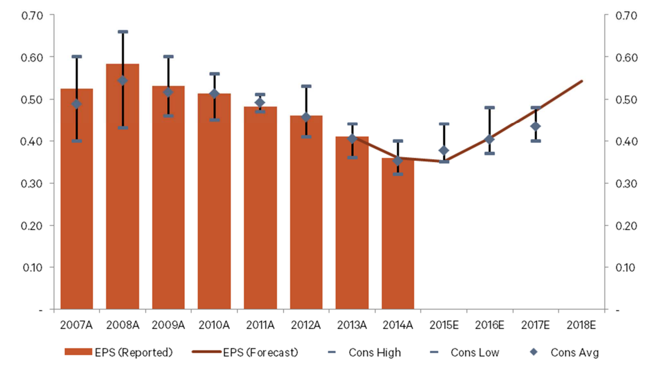
The charts below show our EBITDA and EPS forecasts against consensus.

Berenberg EBITDA versus consensus (€m)



Source: Company reports, Berenberg estimates, Bloomberg

Berenberg EPS versus consensus (€/share)



Source: Company reports, Berenberg estimates, Bloomberg

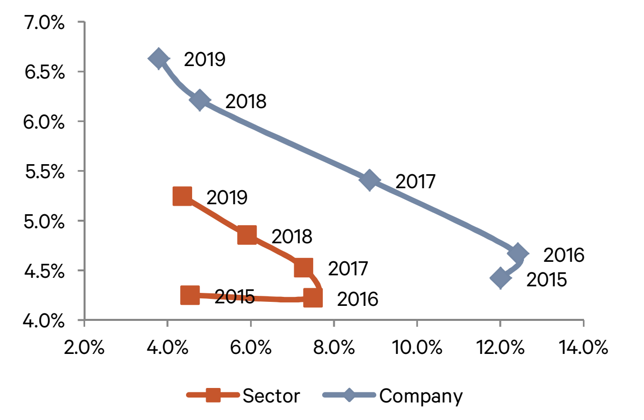
Relative and absolute valuation

We value Iberdrola using a blend of metrics: DCF-based sum-of-the-parts, a dividend discount model, target yield and target P/E.

Our blended price target is €7/share (16% upside). This offers a total shareholder return of 20%.

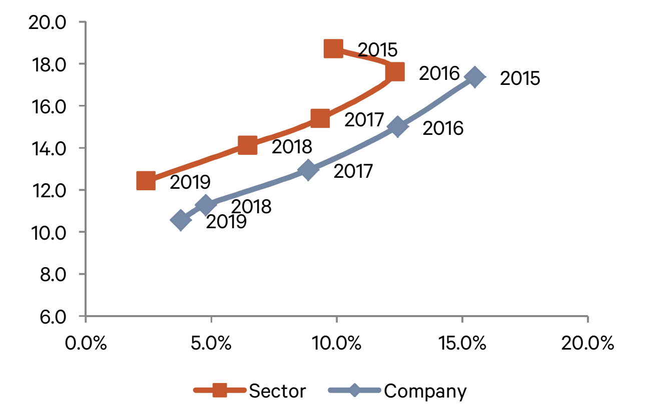
The charts below show Iberdrola's growth rates, P/E and dividend yield relative to the sector.

Yield versus DPS CAGR (three-year forward); stock versus sector



Source: Berenberg estimates, Bloomberg

P/E versus EPS CAGR (three-year forward); stock versus sector



Source: Berenberg estimates, Bloomberg

Blue-sky/doomsday scenario

Our black-sky/blue-sky price target range is €7.6/€6.4 per share. Our blue-sky valuation gives 25% upside. The scenarios are based on different assumptions for Iberian power prices, wind output and carbon prices.

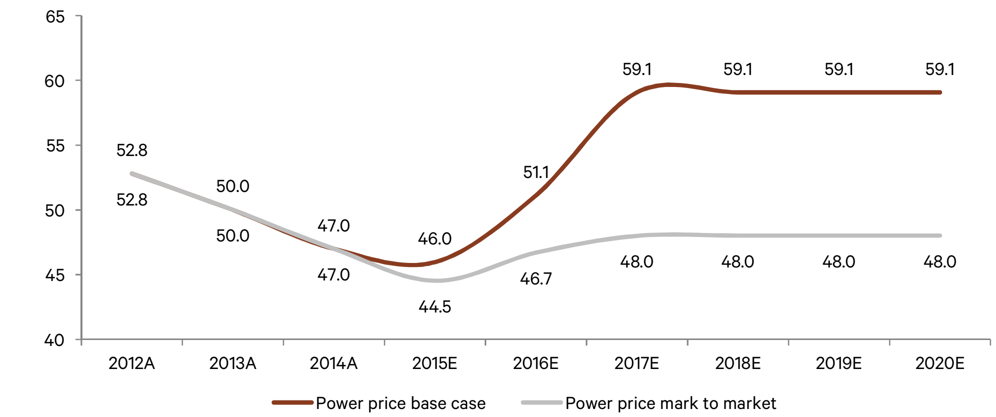
Key investment point one: power price upside

- **Iberian power prices are set to rise. A +/-€5/MWh move in the power price affects EPS by c4-6%.**
- **Iberia is substantially oversupplied and 2015 hydro conditions are currently above the average for 2007-14.**
- **Commodities are, therefore, the key drivers of the power price. We continue to be carbon bulls. Coal should also recover, though not until 2017.**

Iberian power prices set to rise

Our sensitivity analysis shows that a €5/MWh move in the Iberian power price translates into a c4-6% EPS change (on an unhedged basis). Iberdrola has c40TWh of hydro and nuclear generation, ie a +/- €5/MWh would equal +/-c€275m in additional EBITDA. Carbon and coal prices are still subdued today. However, we see a number of catalysts on the horizon that should lead to a recovery in both commodities, more so (and sooner) for carbon. This in turn should lead to higher power prices. We expect an €11/MWh, 23%, improvement in the forward curve by 2017.

Spanish power prices are set to rise (€/MWh)

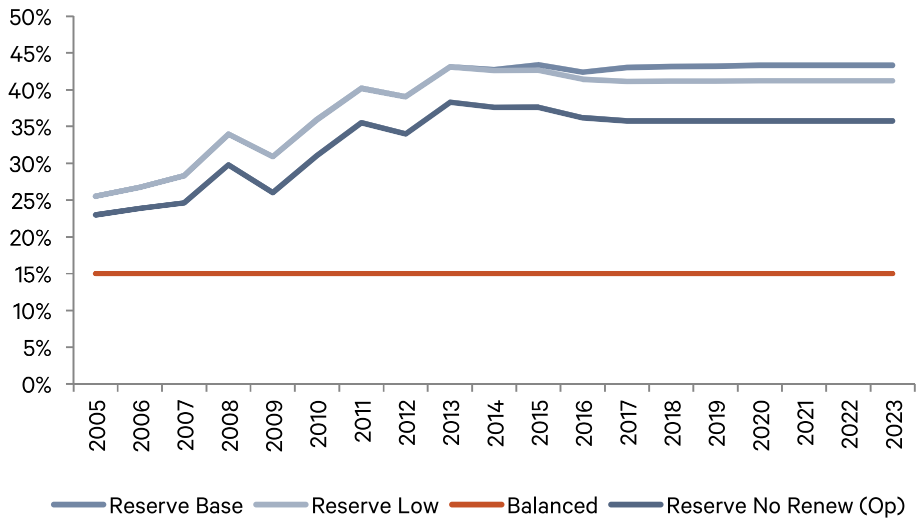


Source: Berenberg estimate

The Iberian market will be over-supplied for years

The Iberian market is vastly over-supplied over the next couple of years, with the majority of capacity relating to young combined cycle gas turbine (CCGT) plants (26% of total capacity). The reserve margin below shows spare capacity with the availability of renewables de-rated and unadjusted.

The Iberian market will be over-supplied for years

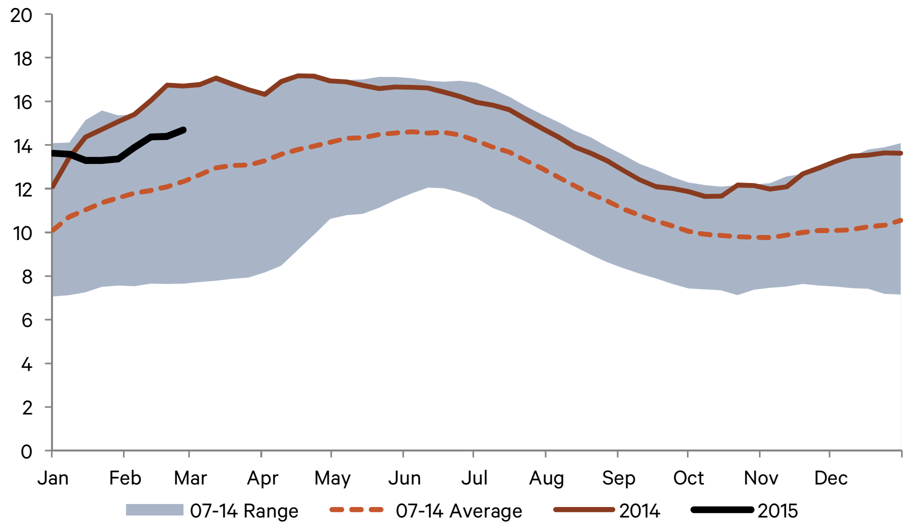


Source: Berenberg discussions with numerous sources

Hydro levels below 2014 but above average

Hydro levels are always difficult to predict. 2014 was a very wet year, with Iberdrola's hydro load factor at 23%. The start of 2015 has seen Spanish hydro levels above the average for 2007-14, but below 2014. We see a load factor of 19% for 2015, while we expect this to fall to a more normalised 17% by 2016. A +/-1 TWh change in hydro output affects net income by +/-2%.

2015 hydro output versus 2014 and 2007-14 average

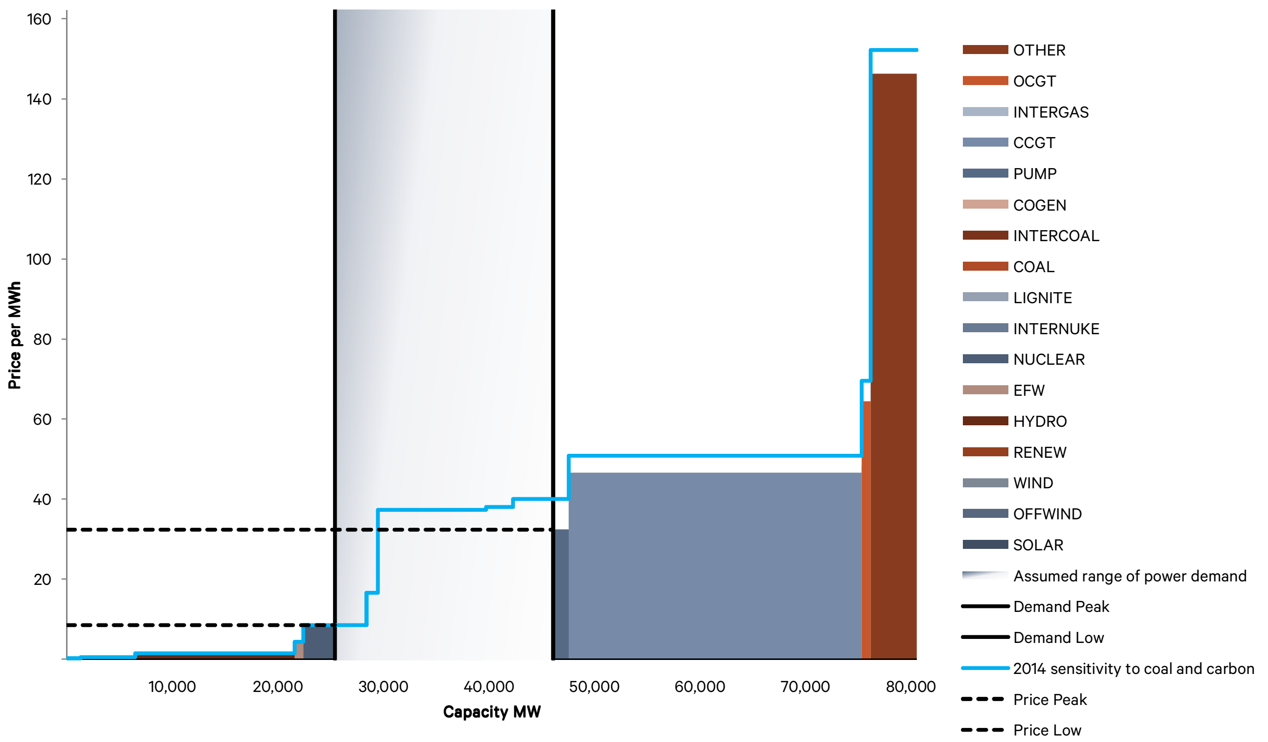


Source: Berenberg estimates

Rising commodity prices are the key electricity price drivers

Nevertheless, power prices and earnings will rise, driven by rising commodity prices (see chart below).

Iberian dispatch curve with higher coal (+$10/tonne) and carbon (+€10/tonne) prices



Source: Berenberg discussions with numerous sources

The key drivers of higher carbon prices are:

- reduction of surplus permits;
- adoption of an MSR; and
- more aggressive EU emissions targets for 2030.

The key drivers of higher coal prices are:

- higher demand (mostly in Asia);
- capacity closures (many mines are trading at a loss);
- regulations reducing illegal mining (Indonesia); and
- US export retrenchment.

Overleaf, we show our carbon snapshot as well as the Berenberg Utility Dispatch (BUD) model for the Iberian region. (For more details on our BUD model, please see *Power lifting*, 18 September 2014).

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Commodity snapshot – carbon: one more step

Carbon: the Berenberg view

- There is now political will to fix the oversupplied CO_2 market (as per ENVI's proposal on 24 February 2015). We believe this could result in a carbon rally to €15/tonne by 2017. That €10/tonne rally boosts our European power prices by an average €9/MWh by 2017.
- Improving the system will centre on the MSR front-loaded into 2018, putting back-loaded emissions into the MSR and tightening emission targets.
- The UK carbon price is at a premium due to the UK carbon floor. It is currently fixed at an £18/tonne premium to the EU Emissions Trading System price.

Forward carbon price (€/tonne)

Source: Bloomberg

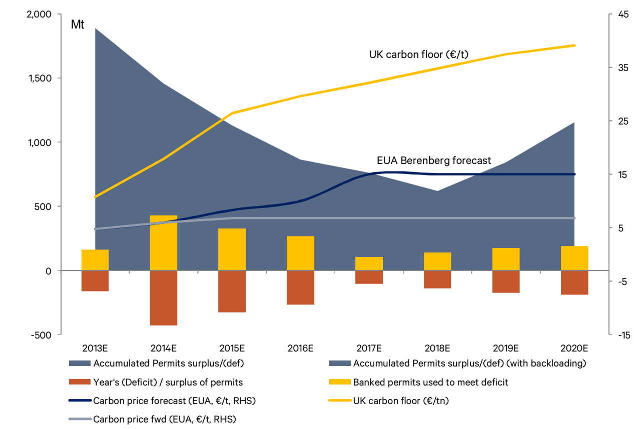
Bull case

- EU changes to phase IV as described above
- Permit cancellations/supply restrictions
- Industrial emissions pick up on the back of higher economic activity – we assume 2% growth a year
- Thermal power plants increase emissions as their output picks up on the back of higher demand – we assume 1% pa from 2015

Bear case

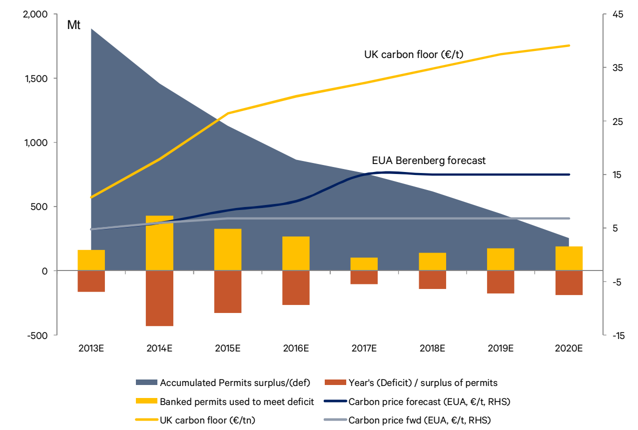
- Failure to implement phase IV tightening
- General efficiencies reduce emissions – we assume zero improvements
- More Clean Development Mechanism (CDM) projects make the cut – we assume zero come through due to tight(er) restrictions and the low carbon price
- New entrant reserve (NER) is abolished, freeing up 5% of the system's annual permits

Demand/supply: no change to the status quo



Source: Berenberg, EU

Demand/supply: backloading taken out



Source: Berenberg, EU. NB ignores MSR bands

Data overview (mt) – assuming no change, ie the status quo

Carbon Market Summary	Unit	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Theoretical allocation of permits		2,084	2,046	2,008	1,970	1,931	1,893	1,855	1,816
New Entrant Reserve (revenue for CCS and new entrants)		(189)	(87)	(85)	(83)	(82)	(80)	(78)	(76)
Less grandfathering free permits to industry		(702)	(627)	(555)	(485)	(418)	(353)	(290)	(229)
Free allocation to new member states		(145)	(130)	(115)	(98)	(81)	(63)	(42)	
Backloading adjustment		-	(400)	(300)	(200)	-	-	-	-
Auction shortfall		(70)							
Actual permits auctioned		979	802	953	1,102	1,351	1,398	1,445	1,511
Demand (emmissions) excluding free permits from grandfathering		1,141	1,231	1,280	1,369	1,455	1,539	1,620	1,700
(Deficit) / surplus of permits		**(162)**	**(429)**	**(328)**	**(266)**	**(104)**	**(141)**	**(175)**	**(189)**
Banked EUA permits used to meet deficit		162	429	328	266	104	141	175	189
Banked CER/EUR permits used to meet deficit		-	-	-	-	-	-	-	-
Net (deficit)/surplus for the year		-	-	-	-	-	-	-	-
Surplus of permits carried forward to following year		1,888	1,458	1,131	864	760	619	444	255

Source: Berenberg EU

Iberdrola SA

Utilities – Energy/Integrated

BUD: Iberian electricity market snapshot

Statistics

Total capacity:	118.0GW
Demand range:	25.4-46.1GW
Plants/projects analysed:	3,687
Marginal fuel:	Coal

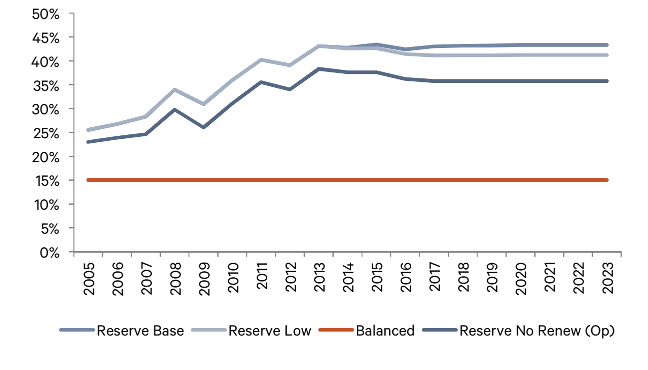
Source: Berenberg estimates, Platts, Bloomberg

Key points

- Substantial over-supply
- It will take a long time for the effects of over-investment to work its way out of the system
- Government tinkering with remuneration has, at least, put a halt to new investment
- Little need for capacity payments, even though a mechanism exits

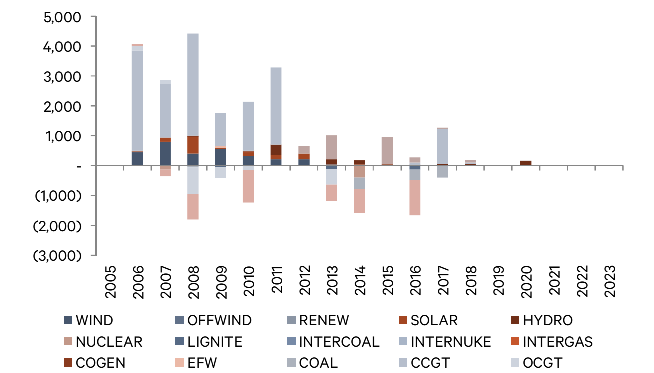
Source: Berenberg estimates, Platts, Bloomberg

Reserve margin over-supplied for years



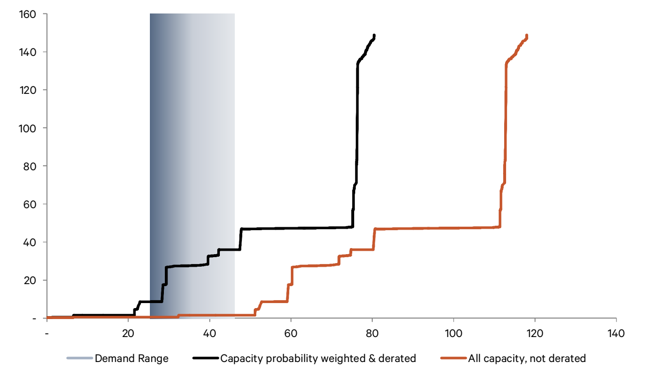
Source: Berenberg estimates, Platts, Bloomberg

Capacity additions/retirements (probability weighted)



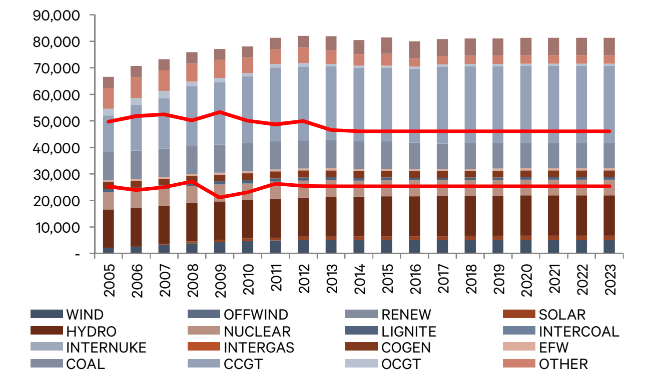
Source: Berenberg estimates, Platts, Bloomberg

Supply curve with and without renewables



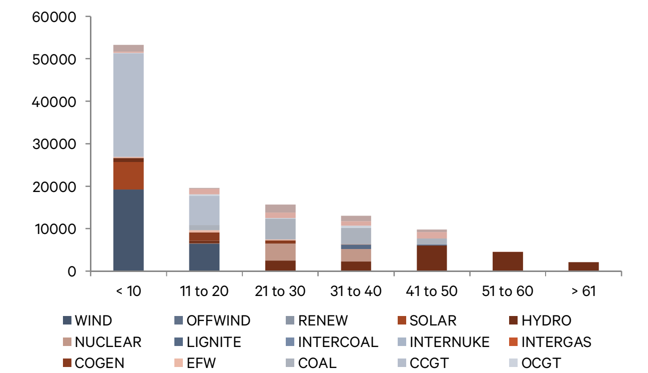
Source: Berenberg estimates, Platts, Bloomberg. Note: y-axis €/MWh, x-axis MW

Rolling merit order (MW)



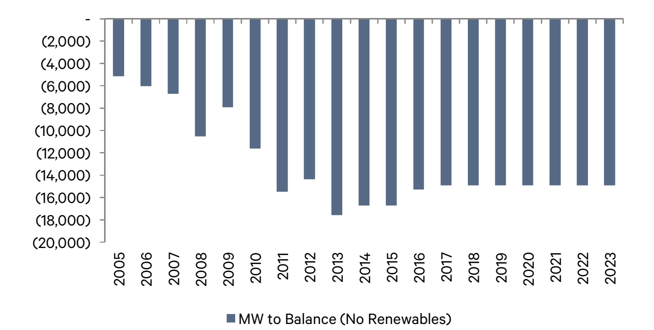
Source: Berenberg estimates, Platts, Bloomberg

Age distribution of plant



Source: Berenberg estimates, Platts, Bloomberg

Capacity needed to back up renewables (MW)



Source: Berenberg estimates, Platts, Bloomberg

UK generation: outlook remains tight

UK generation accounts for c6% of group EBITDA (c10% including UK wind). Generally, the outlook for UK generation should be considered positive. Capacity margins are tightening and, eventually, the Electricity Market Reform (EMR) should provide support for thermal generators as well as renewables. It is not plain sailing, however. For example, the political environment could limit the ability of generators to benefit from higher prices.

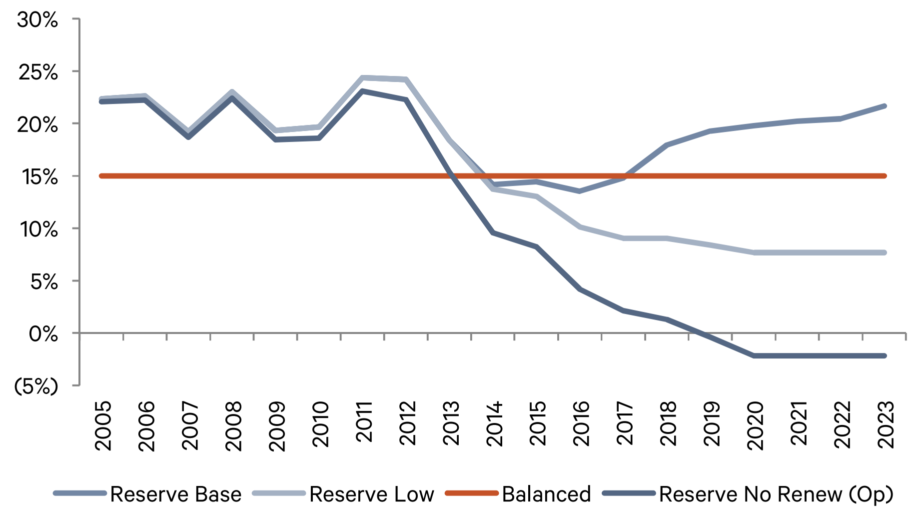
Tight generation markets look set to remain for some time

A lack of spare generation capacity looks set to remain a feature of the UK market for the foreseeable future. The chart below outlines three different scenarios. In each case, the reserve margin for generation falls below the symbolic 15% threshold this year. The implication of this is that power prices, in a normal demand environment, should rise.

Briefly, the three scenarios are as follows.

- **Reserve Base:** Capacity is de-rated to reflect the intermittency of supply (eg renewables) and new capacity is adjusted for the probability that it will be built (ie dependent on its stage of development).
- **Reserve Low:** This shows operational capacity only, also de-rated for intermittency of supply. It represents the outlook for capacity if no new assets are added to the system. This is useful in the light of the current hiatus in investment created by the political climate.
- **Reserve No Renew:** This is a black-sky scenario. It shows the amount of spare operational capacity in the system, assuming that there is zero availability from renewables. We also assume no new construction. It shows just how much pressure the system might face in the event that the sun does not shine and the wind does not blow.

Tightening UK electricity reserve margin



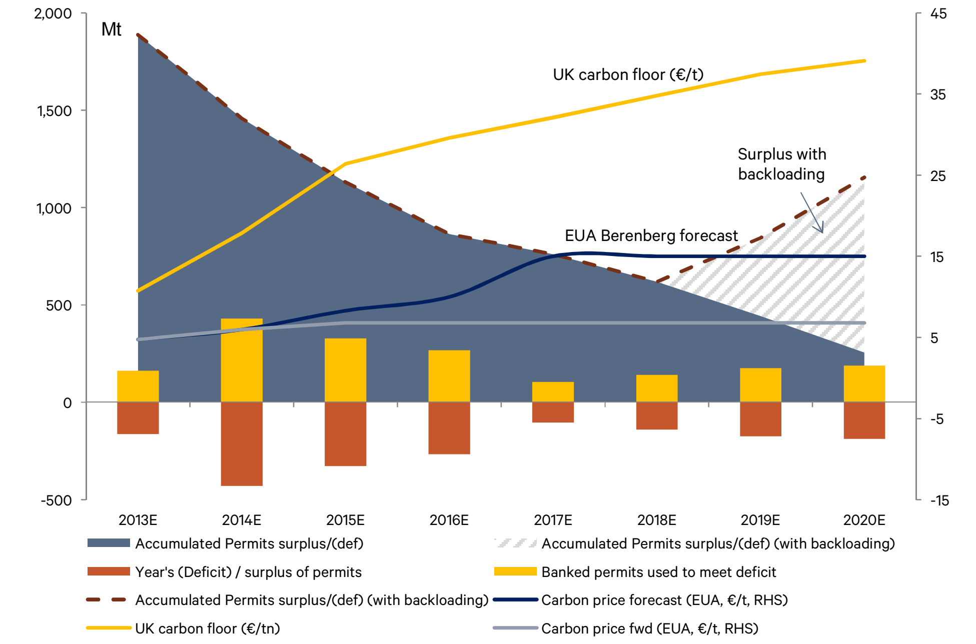
Source: Berenberg estimates, Platts, Bloomberg, industry sources.
Reserve Base assumes plants in operation and under construction. Reserve Low derates capacity. Reserve No Renew assumes no wind or solar availability.

A tightening UK power market would, ordinarily, be good news for Iberdrola. However, political pressures in UK supply mean that the group can no longer be regarded as an all-out beneficiary of rising wholesale gas or power prices. There is a greater risk that higher profits would be clawed back through government intervention, particularly (but by no means exclusively) if the Labour Party wins the next election. That said, given the UK's need for investment in new generation capacity, the electricity industry's negotiating position should improve over time.

UK carbon supports power prices

In the 2014 budget, it was announced that the Carbon Price Support rate will be £9.55/tonne for 2014/15, £18.08/tonne in 2015/16, and capped at £18/tonne from 2016/17 to 2019/20. Despite the cap, the UK's carbon policy should lead to UK power prices being significantly above those of Europe throughout the coming decade. As a result, clean generation will be well positioned to benefit – particularly low-fixed-cost assets, such as hydro, nuclear and wind.

UK carbon price evolution and European carbon permits



Source: Berenberg estimates, Bloomberg

Outcome of the first UK capacity auction was disappointing

There are no two ways about it: the outcome of the first UK capacity auction in December 2014 was disappointing. The government procured 49GW of capacity at a clearing price of £19.4/kW, well below market expectations (and our low-end forecast of £25/kW). Of that, only 2.6GW of qualifying capacity was new-build. Not only that, these plants will receive a capacity price well below the £25/kW maximum price for existing plants.

In a way, the result confirmed our suspicions that, for all the detailed analysis that can be done to try to second guess exactly what each marginal plant will require to stay economical, the primary goal is to make sure that capacity exits. In other words, bid low (we have seen similar things in other capacity markets, such as Brazil in the past).

We also believe that the result is symptomatic of the current investment hiatus in the UK caused by the political environment enveloping the power sector. The Government wants to keep old plants running and will not commit to new investment.

Extensive and expensive intervention is not a given; common sense should prevail

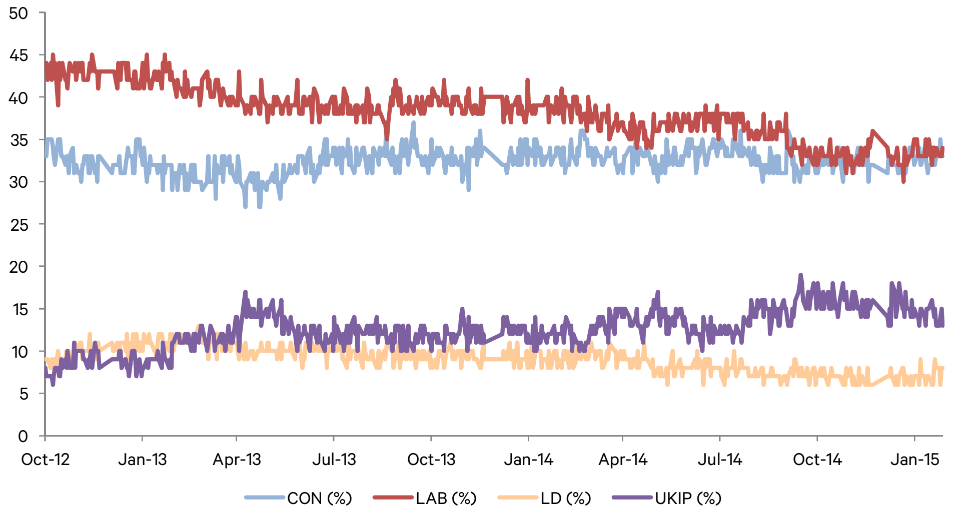
We have written in detail on the UK energy debate in previous notes. Rather than cover every inch of old ground (see *On a firmer footing*, 10 March 2014), we have summarised the key points underpinning our view below.

- The potency of Labour's end-2013 energy tariff freeze pledge has been diluted somewhat by the referral of the industry to the CMA alongside companies' decisions to initially announce their own tariff freezes and, most recently, cut tariffs.
- An outright Labour victory in the election, or a Labour-Lib Dem coalition, presents the biggest risk for the supply companies. Both of these potential governments may well

try to act before the CMA investigation completes. In the meantime, the Labour Party will continue to put energy at the top of the pre-election debate list.

- In our view, a tariff freeze would be unworkable and, actually, reduce competition (see *On a firmer footing*, 10 March 2014). Therefore, it is unclear whether the Labour Party could devise a workable plan, in particular, ahead of the CMA publishing its findings (due in November/December 2015).
- The Labour Party may not win the next election (see poll charts below). Political intervention may not, therefore, be as extensive or as direct as the market fears.

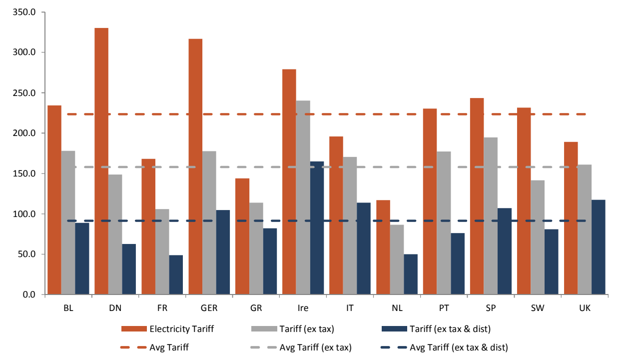
Labour's lead falling in YouGov polls



Source: Berenberg estimates, YouGov

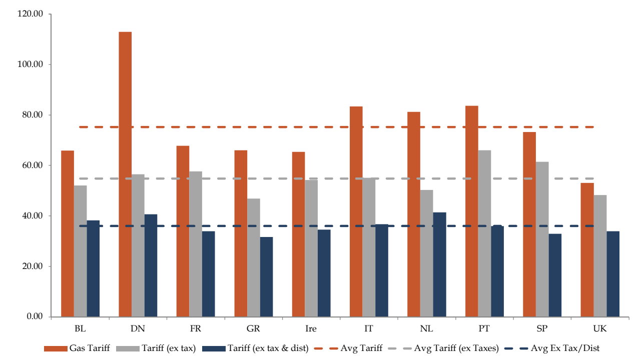
- We expect common sense to prevail when the CMA report is published. In our previous reports (see *On a firmer footing*, 10 March 2014) we highlighted that numerous earlier reviews (by Ofgem) have found that the market may be in need of a helping hand, but is not deliberately smothering competition. Meanwhile, UK energy tariffs actually compare quite well with those across the rest of Europe. Finally, the bigger picture must also encompass the UK's need for significant investment in energy infrastructure in the coming years (generation in particular). The companies at the forefront of this investment are the big six energy suppliers. At the same time, too much intervention is likely to put off potential new entrants. At some stage, the current hiatus in investment needs to be broken; a compromise must be found.

Electricity tariffs: UK versus Europe



Source: Berenberg, VaasaETT

Gas tariffs: UK versus Europe



Source: Berenberg, VaasaETT

- As with previous supply market reviews, we believe the most likely outcome is a bill of health that reads: "Competition is generally okay, but could do better".

- The industry has been accused of being non-competitive and even in collusion. This is because firms tend to change energy tariffs within the same windows and by similar magnitudes. For us, this does not reflect a lack of competition. Instead, it reflects the fact that tariffs are driven by powerful common factors, mainly wholesale energy prices and government policy (ie renewable subsidies, green levies and, in the future, capacity payments). These forces are the same for all firms.
- The industry has also been accused of being slow to pass on falling wholesale costs (eg gas and electricity; note the headlines over the last two weeks). This is, in part, due to hedging and, in part, due to the wholesale energy costs only making up a proportion of the total bill (others include network charges, supplier costs and environmental charges). The delay in passing on wholesale reductions also arises because the companies, historically, have tried to recover margin incurred during periods when prices have increased. In other, words, there are numerous other explanations for this, beyond anti-competitive behaviour.

If either the Labour Party or the CMA were to impose harsh sanctions on the industry that were of such a magnitude that the margin of the UK's largest supplier British Gas (Centrica) was cut to zero (or, for that matter, by two thirds), numerous other suppliers (large and small) would struggle to make a profit. They may well leave the industry and competition would take a step backwards.

Iberdrola SA

Utilities – Energy/Integrated

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BUD: UK electricity market snapshot

Statistics

Total capacity:	90.5GW
Demand range:	23.7-56.8GW
Plants/projects analysed:	1,815
Marginal fuel:	Gas/Coal

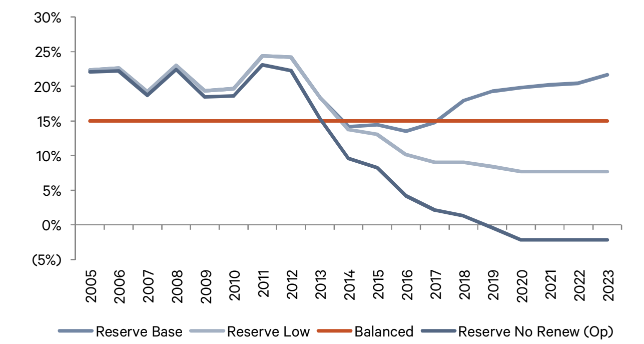
Source: Berenberg estimates, Platts, Bloomberg

Key points

- Substantial over-supply
- Capacity margins are already at squeezed levels and, if the investment hiatus continues, prices are likely to be pushed higher
- Political change needed to free up investment
- Solar expected to continue to grow strongly
- Capacity markets needed already

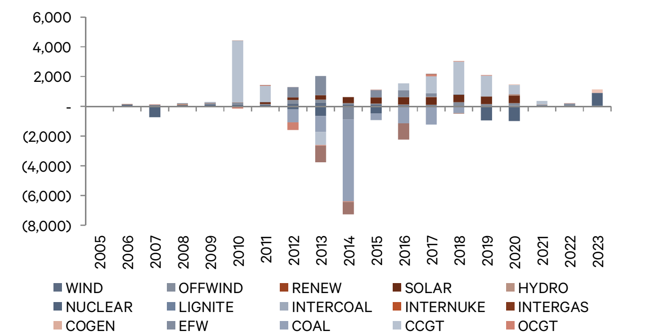
Source: Berenberg estimates, Platts, Bloomberg

Reserve margin tightening quickly



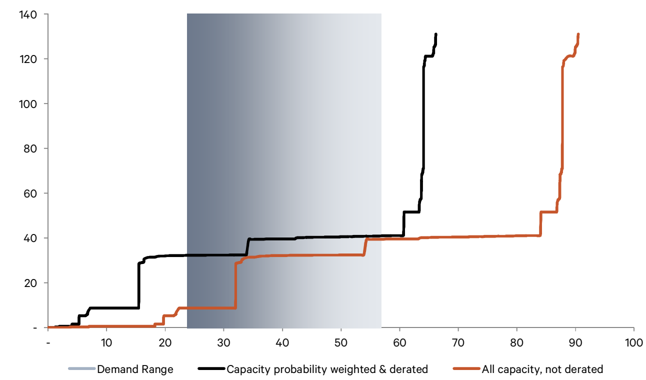
Source: Berenberg estimates, Platts, Bloomberg

Capacity additions/retirements (probability weighted)



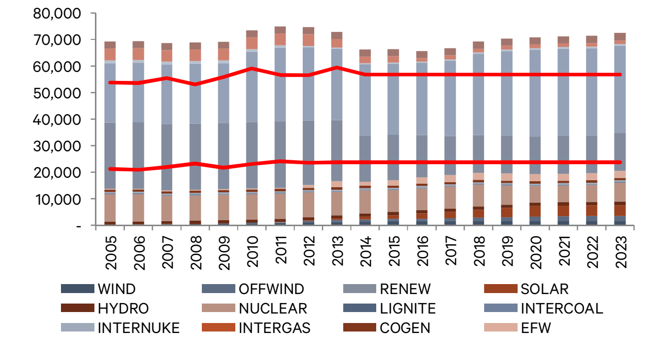
Source: Berenberg estimates, Platts, Bloomberg

Supply curve with and without renewables



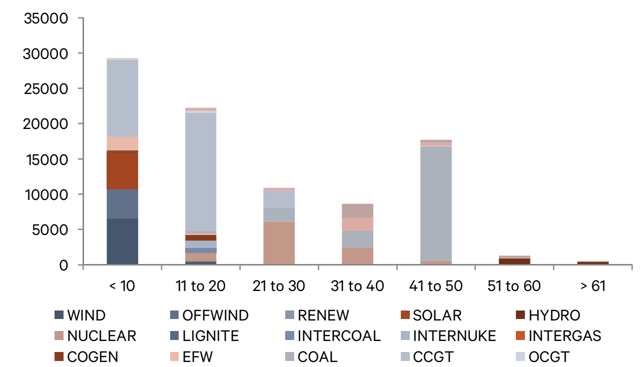
Source: Berenberg estimates, Platts, Bloomberg. Note: y-axis €/MWh, x-axis MW

Rolling merit order (MW)



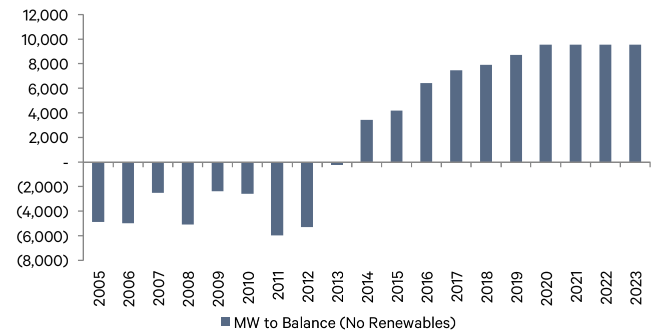
Source: Berenberg estimates, Platts, Bloomberg

Age distribution of plant



Source: Berenberg estimates, Platts, Bloomberg

Capacity needed to back up renewables (MW)



Source: Berenberg estimates, Platts, Bloomberg

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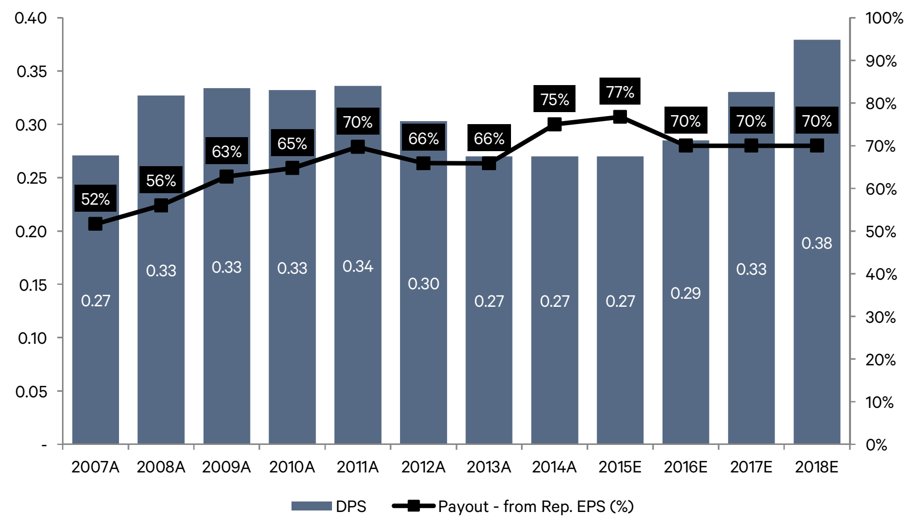
Key investment point two: dividend sustainable with above sector growth

- **We expect DPS CAGR of 11% for 2015-17**
- **Payout ratio of 70% comfortably maintained as Iberdrola is cash flow positive after capex and dividends**
- **Cheap on yield/DPS CAGR versus the sector – also cheap on PE/EPS CAGR**

Iberdrola's dividend policy is to pay a minimum of €0.27 per share, in either shares or cash, and with a payout ratio between the mid-60%s and mid-70%s.

Cash flow should be positive after dividends for the next several years. This is still the case if we strip out disposals. We estimate a 70% payout ratio for the foreseeable future. Even if there was no scrip take-up on the dividend, group cash flow should just about be in positive territory, on our estimates.

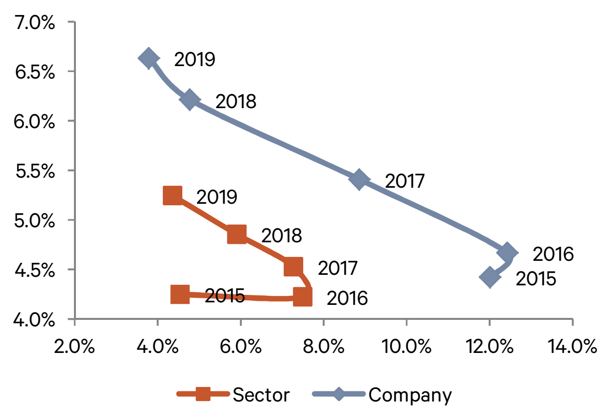
Dividend growth in sight



Source: Berenberg estimates

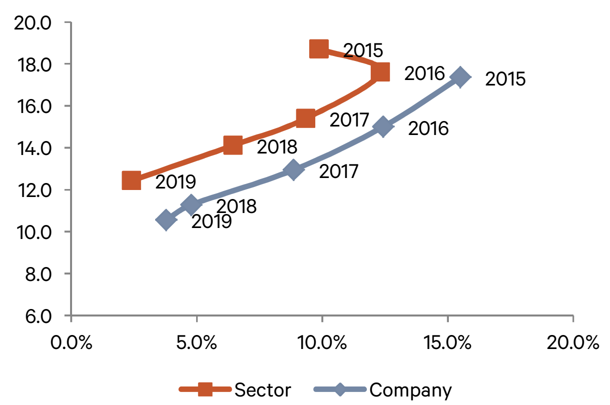
Iberdrola's dividend growth is superior to that of the sector, as is its yield. It also looks cheap on a P/E and EPS growth basis.

Yield versus DPS CAGR (three-year forward); stock versus sector



Source: Berenberg estimates, Bloomberg

P/E versus EPS CAGR (three-year forward); stock versus sector



Source: Berenberg estimates, Bloomberg

Key investment point three: M&A: the big one is out of the way

- **The UIL merger is a sensible deal**
- **Iberdrola USA could provide up to 20% upside to Iberdrola**

Now that Iberdrola plans to merge with UIL (see below), we expect that to be the end of acquisitions (for now!). Likely future North American focus should be on capex spend in the north east of the US (regulated) and projects (Mexico).

The UIL merger is a sensible deal

Iberdrola plans to merge with Connecticut-based utility UIL: This will pool Iberdrola's US/Mexican assets with UIL's, creating Iberdrola USA. UIL's shareholders will own 18.5% of the combined entity and will receive €533m ($597m converted at EUR:USD = 1.12) in cash (a 20% premium to the recent UIL share price). Iberdrola USA will be NYSE listed (which provides future optionality should it wish, or need, to sell down). This should boost Iberdrola's valuation by 20%. US/Mexico will increase from 23% of EBITDA to 26%. The company will have a more-stable business mix as networks and renewables will increase from 51% of the business to 55%, while generation and supply will shrink from 33% to 27%.

Valuation is a little rich, but only on the cash paid. An implied P/E multiple of c21x looks high, but incorporates a 20% bid premium on the cash.

Strategically sensible: The geographical proximity of UIL to Iberdrola's existing assets makes the merger a natural fit. Even though there are different state regulators, the group should be able to leverage best practice, economies of scale and create synergies. Iberdrola will have more exposure to regulated businesses, the US and the US dollar.

Regulatory hurdles look low: Achieved returns are similar to allowed returns, so the likelihood of a rate review looks low. A merger may, however, trigger a rate review, should the regulators play hard ball.

Valuation uplift: Listing the US business at a time when US utilities are trading at premium valuations to their European counterparts should provide an uplift to Iberdrola's valuation (without any need to sell assets). We estimate this could be worth 20% (see below).

Dividend policy will remain unchanged: A payout ratio of 65-75% will continue to be applied. Any shares issued via scrip will be bought back in the market. If our bullish forecasts for carbon prices prove true, Iberdrola will be able to deliver 11% DPS CAGR 2016-18 (slightly less post-acquisition). That is substantially above a mark to market 6% growth rate. We do not believe that is being priced into the shares.

Iberdrola USA could provide up to 20% upside to Iberdrola

If we assume that Iberdrola USA will trade on US sector multiples (15.3x PE 2017), then we can calculate the value of the remaining stub of the business. That would put the stub on 12.3x P/E 2017. The sector is trading 26% higher at 15.4x. Consequently, for Iberdrola shares as a whole, we would expect 20% upside (77% of net income is the stub).

20% share upside from Iberdrola USA (€m)

Iberdrola USA net income	684
Stub net income, ie group exc USA	2,330
Value of Iberdrola USA based on US PE's	10,471
Existing market cap	39,187
Value of stub (group exc USA)	28,715
Implied PE of stub	12.3x
European sector PE	15.4x
Sector Premium to Iberdrola stub	25%
Iberdrola share price upside	19%

Source: Berenberg estimates, Bloomberg

Below we show our estimates of Iberdrola USA's financials.

Iberdrola USA estimates (€m)

	2015E	2016E	2017E	2018E	2019E
EBITDA	1,608	1,736	1,785	1,830	1,875
Networks	806	841	878	915	952
Generation & Supply	387	449	445	445	445
Renewables	415	447	462	470	477
Depreciation	(660)	(686)	(661)	(636)	(633)
Networks	(248)	(253)	(258)	(264)	(269)
Generation & Supply	(182)	(204)	(179)	(156)	(155)
Renewables	(230)	(229)	(224)	(216)	(209)
EBIT	948	1,050	1,124	1,193	1,242
Networks	558	588	620	651	683
Generation & Supply	205	245	267	289	290
Renewables	185	217	238	253	268
Net income	552	629	684	736	772

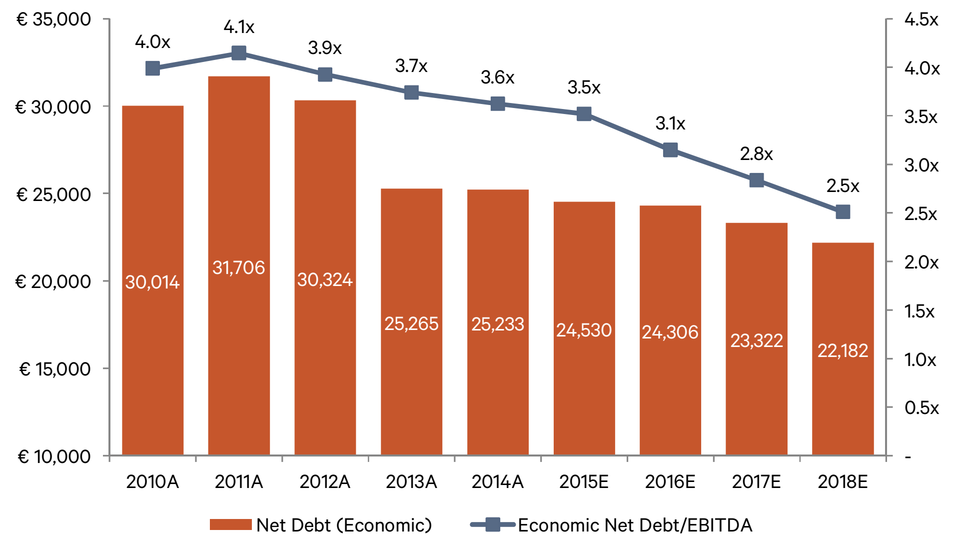
Source: Berenberg estimates, Bloomberg

Key investment point four: an improving financial position

- **Net debt/EBITDA should fall from 3.6x in 2014 to 2.5x by 2018**
- **Most of this should be driven by an increase in EBITDA**
- **Net debt should also fall**

We estimate that Iberdrola will reduce its debt pile from €25bn at end-2014 to €22bn by 2018. Net debt/EBITDA will fall from 3.6x to 2.5x over this period. This includes the UIL merger and Brazilian disposals of Coelba and Cosern. Bearing in mind the large proportion of regulated businesses (in excess of 80%), that gearing does not seem excessive.

Net debt reducing and leverage falling through to 2018



Source: Berenberg estimates

Of course, given its high proportion of earnings from regulated or semi-regulated activities, it is possible for Iberdrola to operate with debt above 3.0x EBITDA. The group is likely, therefore, to redeploy this financial headroom. Following the UIL merger, however, investment in organic growth opportunities looks more likely than another big North American M&A transaction.

Other key issues

UK distribution review (RIIO-ED1)

At the end of November 2014, Ofgem presented its final determination for the RIIO-ED1 electricity distribution price control review for the eight years starting in April 2015. RIIO-ED1 proposes a real reduction of the share of distribution charges in average customer bills; Ofgem claims it should cut consumer bills by between £18-27 a year. Average allowed revenues will fall by 4.7% relative to Ofgem's Distribution Price Control Review 5 (DPCR5), which controls prices up to 31 March 2015. The WACC is unchanged from the draft determinations, using a 6% estimated cost of equity. Ofgem issued licence conditions implementing these determinations in February of this year. However, Centrica and the Northern Powergrid businesses have since appealed against Ofgem's determination. The appeals are now being considered by the CMA. If the CMA decides to investigate, it has six months to reach a conclusion. It is possible, therefore, the RIIO-ED1 outcome will be changed.

Brazilian government offers support amid continuation of drought

The continuing Brazilian drought (its worst for 80 years) has forced the regulator, ANEEL, to award large tariff hikes. The extraordinary tariff revision of 32.18% for EDP Bandeirante and 33.27% for EDP Escelsa should be a positive read across for Iberdrola. It shows that Brazil takes energy and, therefore, utilities profits seriously. In any case, Iberdrola's Brazilian exposure is just 7% of group profits.

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Sensitivity analysis

The following table highlights Iberdrola's key sensitivities.

Sensitivity analysis

Sensitivities	2012A	2013A	2014A	2015E	2016E	2017E
EBITDA Sensitivity* to						
+/- 5 €/MWh Iberian power price exc wind	2%	3%	3%	3%	2%	2%
+/- 5 €/MWh Iberian spreads	1%	0%	0%	1%	1%	1%
+/- 10 % Wind Output Spain	1%	2%	1%	1%	1%	1%
+/- 10 % Wind Output USA	0%	1%	1%	1%	1%	1%
+/- 10 % Wind Output UK	0%	0%	1%	1%	1%	1%
+/- 5 €/t Carbon Price	2%	3%	3%	3%	2%	2%
+/- 5 $/t Coal Price	1%	1%	1%	1%	1%	1%
+/- 1 TWh Hydro Output Spain	1%	1%	1%	1%	1%	1%
+/- 5 €/t Carbon Price impact on Power Price	2%	3%	3%	3%	2%	2%
+/- 5 $/t Coal Price impact on Power Price	1%	1%	1%	1%	1%	1%
Net Income Sensitivity* to						
+/- 5 €/MWh Iberian power price exc wind	5%	5%	7%	6%	5%	5%
+/- 5 €/MWh Iberian spreads	1%	1%	1%	1%	1%	1%
+/- 10 % Wind Output Spain	3%	3%	3%	3%	3%	3%
+/- 10 % Wind Output USA	1%	1%	1%	1%	1%	1%
+/- 10 % Wind Output UK	1%	1%	1%	2%	2%	1%
+/- 5 €/t Carbon Price	4%	5%	6%	6%	5%	4%
+/- 5 $/t Coal Price	1%	1%	2%	2%	1%	1%
+/- 1 TWh Hydro Output Spain	1%	2%	2%	2%	2%	1%
+/- 5 €/t Carbon Price impact on Power Price	4%	5%	6%	6%	5%	4%
+/- 5 $/t Coal Price impact on Power Price	1%	1%	2%	2%	1%	1%

* Ceteris Paribus; e.g. does not take account of hedged positions.

Source: Berenberg

Changes to numbers; Berenberg versus consensus

Estimate changes

Estimate Changes	2014A	2015E	2016E	2017E
EBITDA (New - as reported; € m)	**6,965**	**6,971**	**7,720**	**8,224**
EBITDA (Old - as reported; € m)	6,839	6,849	7,128	7,622
Change	*+2%*	*+2%*	*+8%*	*+8%*
EBIT (New - as reported; € m)	**3,941**	**4,041**	**4,632**	**5,140**
EBIT (Old - as reported; € m)	3,856	3,866	4,149	4,647
Change	*+2%*	*+5%*	*+12%*	*+11%*
EPS (New - as reported; €)	0.36	0.35	0.41	0.47
EPS (Old - as reported; €)	0.38	0.36	0.40	0.46
Change	*-5%*	*-3%*	*+2%*	*+2%*
DPS (New - as reported; €)	0.27	0.27	0.29	0.33
DPS (Old - as reported; €)	0.27	0.27	0.28	0.33
Change	*+0%*	*+0%*	*+2%*	*+2%*

Source: Bloomberg

Berenberg versus consensus

Berenberg Forecasts vs Consensus	2012A	2013A	2014A	2015E	2016E	2017E
EBITDA* (€ m)			**6,965**	**6,971**	**7,720**	**8,224**
Consensus (Average)			6,872	7,122	7,370	7,628
Berenberg +/- vs Cons			*+1%*	*-2%*	*+5%*	*+8%*
EBIT* (€ m)			**3,941**	**4,041**	**4,632**	**5,140**
Consensus (Average)			3,941	4,060	4,241	4,487
Berenberg +/- vs Cons			*+0%*	*-0%*	*+9%*	*+15%*
Net Income* (€ m)			**2,327**	**2,247**	**2,602**	**3,014**
Consensus (Average)			2,158	2,357	2,510	2,701
Berenberg +/- vs Cons			*+8%*	*-5%*	*+4%*	*+12%*
EPS* (€)			0.36	0.35	0.41	0.47
Consensus (Average)			0.35	0.38	0.40	0.43
Berenberg +/- vs Cons			*+2%*	*-6%*	*+1%*	*+9%*
DPS (€)			0.27	0.27	0.29	0.33
Consensus (Average)			0.27	0.27	0.28	0.30
Berenberg +/- vs Cons			*-1%*	*-1%*	*+0%*	*+10%*

* Based on company's definition of metric

Source: Berenberg estimates, Bloomberg

Key assumptions

Key assumptions

Power Price Forecasts		2014A	2015E	2016E	2017E	2018E	2019E	2020E
Country	**Unit**							
UK (Local)	£/MWh	47.0	48.7	52.0	53.2	54.7	55.8	55.4
UK (EUR)	EUR/MWh	58.5	64.3	70.0	71.2	73.1	74.6	74.2
Germany	EUR/MWh	35.0	32.3	37.1	43.0	42.5	42.5	42.5
Nordic	EUR/MWh	33.1	30.4	32.1	36.7	36.4	36.4	36.4
Italy	EUR/MWh	52.9	54.4	49.5	51.8	4.5	4.5	4.5
Benelux	EUR/MWh	47.0	42.3	44.6	52.1	52.0	52.0	52.0
France	EUR/MWh	47.0	42.3	44.6	52.1	52.0	52.0	52.0
Spain/Portugal	EUR/MWh	47.0	46.1	49.4	59.2	59.2	59.2	59.2

Fuel Price Forecasts		2014A	2015E	2016E	2017E	2018E	2019E	2020E
Fuel	**Unit**							
Oil (Brent)	$/bbl	101.9	47.1	69.3	72.6	72.6	72.6	72.6
Coal	$/t	78.3	58.7	66.4	74.6	74.6	74.6	74.6
Gas (Europe LTC)	EUR/MWh	26.4	26.4	26.4	26.4	26.4	26.4	26.4
Gas (Italy)	EUR/MWh	23.2	23.3	23.3	23.3	23.3	23.3	23.3
Gas (UK) £	£/MWh	16.6	15.8	15.9	16.0	16.2	16.2	16.2
Carbon UK floor	£/t	14.3	20.0	22.0	24.0	26.0	28.0	29.2
US Gas Henry Hub	$/MWh	14.7	10.6	11.3	12.1	12.4	12.7	13.1
Uranium	EUR/MWh	8.5	8.5	8.5	8.5	8.5	8.5	8.5
Carbon	EUR/t	6.0	8.3	10.0	15.0	15.0	15.0	15.0

Year end currency rates	2014A	2015E	2016E	2017E	2018E	2019E	2020E
EURGBP	0.78	0.74	0.75	0.75	0.75	0.75	0.75
EURTRY	2.83	3.00	3.25	3.25	3.25	3.25	3.25
EURSEK	9.44	9.51	9.53	9.53	9.53	9.53	9.53
EURUSD	1.21	1.14	1.16	1.16	1.16	1.16	1.16
EURRUB	73.50	80.14	89.30	89.30	89.30	89.30	89.30
EURMXN	17.84	17.39	18.10	18.10	18.10	18.10	18.10
USDBRL	2.66	3.11	3.38	3.38	3.38	3.38	3.38

Inflation	2014A	2015E	2016E	2017E	2018E	2019E	2020E
Central Europe	0.8%	0.2%	1.2%	2.0%	2.0%	2.0%	2.0%
Eastern Europe	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
UK	1.5%	0.7%	1.6%	1.6%	1.6%	1.6%	1.6%
Nordic	0.5%	0.8%	1.3%	1.3%	1.3%	1.3%	1.3%
Spain/Portugal	-0.2%	-0.7%	0.5%	2.0%	2.0%	2.0%	2.0%
US	1.6%	0.7%	1.7%	1.7%	1.7%	1.7%	1.7%

Source: Berenberg

Financials

Income statement

Income Statement (€ m)	2012A	2013A	2014A	2015E	2016E	2017E
Revenue	34,201	31,077	30,032	29,963	32,353	33,293
Reported EBITDA	**7,726**	**6,757**	**6,965**	**6,971**	**7,720**	**8,224**
Change	*+1%*	*-13%*	*+3%*	*+0%*	*+11%*	*+7%*
Margin	*+23%*	*+22%*	*+23%*	*+23%*	*+24%*	*+25%*
Depreciation	(3,350)	(4,537)	(3,024)	(2,933)	(2,936)	(2,938)
Other OPEX	-	-	-	3	(152)	(146)
Reported EBIT	**4,377**	**2,219**	**3,941**	**4,041**	**4,632**	**5,140**
Change	*-3%*	*-49%*	*+78%*	*+3%*	*+15%*	*+11%*
Margin	*+13%*	*+7%*	*+13%*	*+13%*	*+14%*	*+15%*
Net Financial Expenses	(1,224)	(1,278)	(1,122)	(1,096)	(1,083)	(1,034)
Tax	(172)	1,467	(837)	(765)	(916)	(1,055)
Other	(188)	195	383	115	115	115
Minorities	(28)	(31)	(38)	(48)	(147)	(151)
Reported Net Income	**2,765**	**2,572**	**2,327**	**2,247**	**2,602**	**3,014**
Change	*-1%*	*-7%*	*-10%*	*-3%*	*+16%*	*+16%*
Margin	*+8%*	*+8%*	*+8%*	*+8%*	*+8%*	*+9%*
Number of Shares	6,138	6,240	6,388	6,388	6,388	6,388
Per Share:						
Basic EPS	0.46	0.41	0.36	0.35	0.41	0.47
Change	*-5%*	*-11%*	*-12%*	*-2%*	*+16%*	*+16%*
Reported EPS	**0.46**	**0.41**	**0.36**	**0.35**	**0.41**	**0.47**
Change	*-5%*	*-11%*	*-12%*	*-2%*	*+16%*	*+16%*
DPS	**0.30**	**0.27**	**0.27**	**0.27**	**0.29**	**0.33**
Change	*-10%*	*-11%*	*+0%*	*+0%*	*+6%*	*+16%*
Payout	*66%*	*66%*	*75%*	*77%*	*70%*	*70%*

Source: Berenberg

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Divisional EBITDA

Networks (€ m)	2012A	2013A	2014A	2015E	2016E	2017E
Revenue	8,824	6,694	7,334	7,013	7,256	7,364
Change	+6%	-24%	+10%	-4%	+3%	+1%
% Group	+26%	+22%	+24%	+23%	+22%	+22%
EBITDA	3,774	3,346	3,535	3,612	3,746	3,874
Change	-1%	-11%	+6%	+2%	+4%	+3%
Margin	+43%	+50%	+48%	+52%	+52%	+53%
% Group	+49%	+50%	+51%	+52%	+49%	+47%
EBIT	2,599	2,366	2,455	2,516	2,636	2,749
Change	-7%	-9%	+4%	+2%	+5%	+4%
Margin	+29%	+35%	+33%	+36%	+36%	+37%
% Group	+59%	+107%	+62%	+62%	+57%	+53%

Generation & Supply (€ m)	2012A	2013A	2014A	2015E	2016E	2017E
Revenue	23,568	22,754	21,140	21,209	21,710	22,418
Change	+12%	-3%	-7%	+0%	+2%	+3%
% Group	+69%	+73%	+70%	+71%	+67%	+67%
EBITDA	2,355	1,987	2,292	2,109	2,161	2,426
Change	+4%	-16%	+15%	-8%	+2%	+12%
Margin	+10%	+9%	+11%	+10%	+10%	+11%
% Group	+30%	+29%	+33%	+30%	+28%	+29%
EBIT	1,209	(13)	1,276	1,103	1,165	1,440
Change	+13%	-101%	-9684%	-14%	+6%	+24%
Margin	+5%	-0%	+6%	+5%	+5%	+6%
% Group	+28%	-1%	+32%	+27%	+25%	+28%

Renewables (€ m)	2012A	2013A	2014A	2015E	2016E	2017E
Revenue	2,462	2,384	2,234	2,414	2,596	2,738
Change	+7%	-3%	-6%	+8%	+8%	+5%
% Group	+7%	+8%	+7%	+8%	+8%	+8%
EBITDA	1,620	1,501	1,326	1,483	1,595	1,684
Change	+11%	-7%	-12%	+12%	+8%	+6%
Margin	+66%	+63%	+59%	+61%	+61%	+62%
% Group	+21%	+22%	+19%	+21%	+21%	+20%
EBIT	712	67	501	661	776	868
Change	+14%	-91%	+645%	+32%	+17%	+12%
Margin	+29%	+3%	+22%	+27%	+30%	+32%
% Group	+16%	+3%	+13%	+16%	+17%	+17%

Source: Berenberg

Divisional EBITDA (continued)

Other Businesses (€ m)	2012A	2013A	2014A	2015E	2016E	2017E
Revenue	**581**	**557**	**598**	**598**	**598**	**598**
Change	*-47%*	*-4%*	*+7%*	*+0%*	*+0%*	*+0%*
% Group	*+2%*	*+2%*	*+2%*	*+2%*	*+2%*	*+2%*
EBITDA	**44**	**0**	**(17)**	**(17)**	**(17)**	**(17)**
Change	*-71%*	*-99%*	*-3885%*	*+0%*	*+0%*	*+0%*
Margin	*+8%*	*+0%*	*-3%*	*-3%*	*-3%*	*-3%*
% Group	*+1%*	*+0%*	*-0%*	*-0%*	*-0%*	*-0%*
EBIT	**8**	**(52)**	**(24)**	**(26)**	**(27)**	**(28)**
Change	*-94%*	*-741%*	*-53%*	*+6%*	*+5%*	*+5%*
Margin	*+1%*	*-9%*	*-4%*	*-4%*	*-5%*	*-5%*
% Group	*+0%*	*-2%*	*-1%*	*-1%*	*-1%*	*-1%*

Other* (€ m)	2012A	2013A	2014A	2015E	2016E	2017E
EBITDA	**(67)**	**(78)**	**(171)**	**(216)**	**235**	**257**
o/w Unallocated Cost Savings	-	-	-	-	-	-
o/w Unallocated Aqn / Disp	-	-	-	(44)	406	429
% Group	*-1%*	*-1%*	*-2%*	*-3%*	*+3%*	*+3%*
EBIT	**(150)**	**(149)**	**(267)**	**(213)**	**83**	**111**
o/w Unallocated Cost Savings	-	-	-	-	-	-
o/w Unallocated Aqn / Disp	-	-	-	(44)	246	268
% Group	*-3%*	*-7%*	*-7%*	*-5%*	*+2%*	*+2%*

* Includes, if applicable, other group income/costs and unallocated cost savings, CAPEX returns and acquisitions and disposals

Source: Berenberg

Cash flow statement

Cash Flow (€ m)	2012A	2013A	2014A	2015E	2016E	2017E
Net Income	2,389	2,572	2,327	2,296	2,749	3,166
Depreciation	3,350	4,537	3,024	2,933	2,936	2,938
Working Capital	(305)	(673)	202	(1)	49	19
Other Operating Cash Flow (inc tariff deficit)	1,546	(631)	1,248	-	-	-
Operating Cash Flow	**6,980**	**5,805**	**6,800**	**5,227**	**5,733**	**6,123**
CAPEX	(3,896)	(3,092)	(3,363)	(3,200)	(3,200)	(3,200)
FCF (Post CAPEX)	**3,083**	**2,714**	**3,437**	**2,027**	**2,533**	**2,923**
Acquisitions and Disposals	(319)	(312)	(299)	442	(533)	-
FCF (p. CAPEX, Aq&D)	**2,764**	**2,402**	**3,138**	**2,469**	**2,000**	**2,923**
Other Investment Cash Flow	807	795	1,310	-	-	-
Dividends	(178)	(184)	(187)	(1,766)	(1,777)	(1,939)
FCF (p. CAPEX, Aq&D, Divs)	**3,393**	**3,014**	**4,261**	**703**	**223**	**984**
Buybacks and Equity Issuance	(127)	(370)	(748)	-	-	-
Borrowings	(184)	(3,383)	(2,149)	-	-	(672)
Other Financing, Disc and FX	(2,128)	(212)	(891)	-	-	-
Net Change in Group Cash	**953**	**(952)**	**474**	**703**	**223**	**312**

Source: Berenberg

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Balance sheet statement

Balance Sheet (€ m)	2012A	2013A	2014A	2015E	2016E	2017E
Intangible Fixed Assets	19,403	15,993	16,862	16,862	16,862	16,862
PP&E	53,423	51,204	55,107	54,932	55,730	55,991
Other Non-Current Assets	8,051	12,393	10,483	10,483	10,483	10,483
Total Non-Current Assets	**80,877**	**79,590**	**82,453**	**82,278**	**83,075**	**83,337**
Inventories and Receivables	1,896	7,265	7,559	7,541	8,143	8,379
Cash	3,044	1,332	1,806	2,509	2,732	3,044
Other Liquid Assets	4,047	1,126	1,635	1,635	1,635	1,635
Other Current Assets	6,736	370	320	320	320	320
Assets Held for Sale	216	104	-	-	-	-
Total Current Assets	**15,939**	**10,197**	**11,319**	**12,005**	**12,829**	**13,378**
Total Assets	**96,816**	**89,787**	**93,771**	**94,282**	**95,904**	**96,715**
Short-Term Debt	(5,101)	(3,979)	(5,035)	(5,035)	(5,035)	(5,035)
Payables	(6,113)	(6,797)	(8,175)	(8,157)	(8,807)	(9,063)
Provisions	(435)	(294)	(221)	(221)	(221)	(221)
o/w Nuclear Liabilities	-	-	-	-	-	-
o/w Pensions	-	-	-	-	-	-
o/w Other Provisions	(435)	(294)	(221)	(221)	(221)	(221)
Other Current Liabilities	(2,538)	(86)	(101)	(101)	(101)	(101)
Liabilities of Businesses Held for Sale	-	-	-	-	-	-
Total Current Liabilities	**(14,187)**	**(11,156)**	**(13,532)**	**(13,514)**	**(14,164)**	**(14,420)**
Long-Term Debt	(28,851)	(24,473)	(23,315)	(23,315)	(23,315)	(22,643)
Provisions	(3,928)	(4,065)	(4,852)	(4,852)	(4,852)	(4,852)
o/w Nuclear Liabilities	(561)	(519)	(451)	(451)	(451)	(451)
o/w Pensions	(1,902)	(1,399)	(1,944)	(1,944)	(1,944)	(1,944)
o/w Other Provisions	(1,465)	(2,148)	(2,458)	(2,458)	(2,458)	(2,458)
Other Non-Current Liabilities	(15,765)	(14,804)	(16,281)	(16,281)	(16,281)	(16,281)
Total Non-Current Liabilities	**(48,544)**	**(43,343)**	**(44,448)**	**(44,448)**	**(44,448)**	**(43,776)**
Shareholders' Equity	(33,760)	(34,611)	(34,540)	(35,069)	(36,041)	(37,268)
Minorities	(325)	(153)	(200)	(200)	(200)	(200)
Total Equity	**(34,085)**	**(35,289)**	**(35,791)**	**(36,320)**	**(37,292)**	**(38,518)**
Total Liabilities and Equity	**(96,816)**	**(89,787)**	**(93,771)**	**(94,282)**	**(95,904)**	**(96,715)**
Net Debt (As Reported)	30,324	25,265	25,233	24,530	24,306	23,322
Economic Net Debt	30,324	25,265	25,233	24,530	24,306	23,322
Net Debt / EBITDA (As Reported)	3.9	3.7	3.6	3.5	3.1	2.8
Economic Net Debt / EBITDA	3.9	3.7	3.6	3.5	3.1	2.8

Source: Berenberg

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Date	Price target - EUR	Rating	Initiation of coverage
10 March 14	5.70	Buy	13 October 11
26 August 14	6.10	Buy	
28 January 15	7.00	Buy	

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