Company report

Industrials
Electric Utilities
Equity – Spain

HSBC Global Research

Iberdrola (IBE SM)

Hold

Target price (EUR)			6.70
Share price (EUR)			6.42
Upside/Downside (%)			4.3

Dec	2014a	2015e	2016e
HSBC EPS	0.34	0.40	0.43
HSBC PE	19.0	15.9	15.0

Performance	1M	3M	12M
Absolute (%)	1.5	6.8	16.9
Relative^ (%)	1.1	6.6	9.6

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Issuer of report: HSBC Bank plc, Sucursal en España

Hold: right asset mix already at a premium yield

- **Exposure to network and renewable assets has strategic value whereas QE environment helps on forex translation**
- **But Iberdrola (IBE) already trades at yield premium while uncertainty on Spanish assets could increase during H2**
- **Reiterate Hold rating (TP increased to EUR6.7 from EUR6.3)**

Right asset mix that provides strategic value. Iberdrola has a strong exposure to network and renewable assets (that provide more than 70% of the EBITDA) where growth opportunities are still in demand (areas such as UK, LatAm or the US). The company has hinted at capex increase going forward which in our view makes sense if the company is to sustain greater earnings (and lately dividend) growth. IBE currently has a capex to D&A ratio of 1.0x, which is low for industry standards. We calculate that a capex increase to EUR5.5bn per year (from current EUR3.2bn) would increase this ratio to c1.6x without hindering leverage as a result of additional growth from new capex. The depreciation of the euro due to QE is helping the accounts during this year (45% of the EBIT located in the UK and the US), but we predict limited additional upside for the future on this front.

Premium yield and other concerns. IBE is already reflecting its quality asset mix and improved capital structure trading at a yield premium to the sector (4.2% yield for 2015e-16e versus sector peers at >5%). Even assuming a 15% increase in the current floor DPS (set at EUR0.27), the implied yield would still be at a premium to the sector. Although we see room to improve the dividend outlook sooner rather than later, the upside could be capped taking into account the likely higher capex to be deployed. Moreover, we remained concerned about two main elements in the equity story during H2: 1) the news-flow and the uncertainties that the development of the Spanish general elections could create for the group (as 40% of the EBITDA is still located in Spain) and 2) the potential increase of interest rates in the US (an area where IBE is growing with regulated assets after the proposed acquisition of UIL Holding that is expected to be completed in Q4).

Hold rating maintained (TP increased to EUR6.7 from EUR6.3). The euro depreciation has lifted our financial estimates and boosted the valuation (6.6% increase). Our new TP of EUR6.7 is based on the rounded weighted average of DCF, sum-of-parts and yield valuations. We apply 50% weighting to the yield methodology, 25% to DCF methodology and 25% to the SOP valuation. We reiterate our Hold rating.

Index^	MADRID SE
Index level	1,162
RIC	IBE.MC
Bloomberg	IBE SM

Source: HSBC

Enterprise value (EURm)	66,535
Free float (%)	75
Market cap (USDm)	44,828
Market cap (EURm)	40,829

Source: HSBC

Financials & valuation

Financial statements

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Profit & loss summary (EURm)				
Revenue	30,032	30,846	31,953	32,466
EBITDA	6,965	7,334	7,666	7,855
Depreciation & amortisation	-3,024	-3,083	-3,177	-3,274
Operating profit/EBIT	3,941	4,251	4,489	4,582
Net interest	-1,122	-1,037	-1,010	-1,000
PBT	3,202	3,396	3,615	3,723
HSBC PBT	2,954	3,321	3,615	3,723
Taxation	-837	-560	-904	-931
Net profit	2,327	2,796	2,670	2,749
HSBC net profit	2,113	2,524	2,670	2,749
Cash flow summary (EURm)				
Cash flow from operations	3,929	4,969	5,589	5,766
Capex	-2,848	-3,040	-3,240	-3,221
Cash flow from investment	-1,987	-2,878	-3,240	-3,221
Dividends	-1,030	-1,030	-1,030	-1,030
Change in net debt	-2,335	-219	-477	-674
FCF equity	699	1,747	2,212	2,404
Balance sheet summary (EURm)				
Intangible fixed assets	16,862	17,199	17,543	17,894
Tangible fixed assets	55,107	55,945	57,596	59,180
Current assets	16,387	16,690	17,046	17,314
Cash & others	1,806	1,806	1,806	1,806
Total assets	92,136	92,706	95,132	97,410
Operating liabilities	26,155	26,068	27,749	29,386
Gross debt	27,524	27,305	26,828	26,154
Net debt	25,718	25,499	25,022	24,348
Shareholders funds	35,040	36,152	37,137	38,201
Invested capital	60,395	61,960	62,631	63,196

Ratio, growth and per share analysis

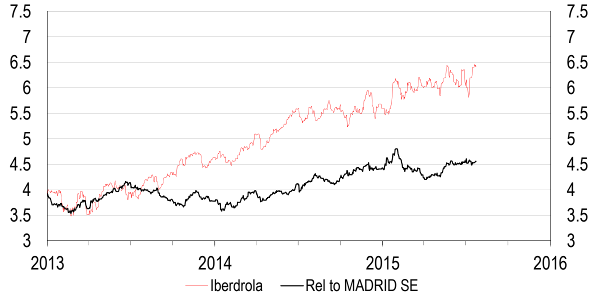
Year to	12/2014a	12/2015e	12/2016e	12/2017e
Y-o-y % change				
Revenue	-8.5	2.7	3.6	1.6
EBITDA	-3.3	5.3	4.5	2.5
Operating profit	61.8	7.9	5.6	2.1
PBT	168.9	6.1	6.5	3.0
HSBC EPS	-2.8	19.4	5.8	3.0
Ratios (%)				
Revenue/IC (x)	0.5	0.5	0.5	0.5
ROIC	4.7	5.8	5.4	5.5
ROE	6.0	7.1	7.3	7.3
ROA	3.5	4.0	3.7	3.7
EBITDA margin	23.2	23.8	24.0	24.2
Operating profit margin	13.1	13.8	14.0	14.1
EBITDA/net interest (x)	6.2	7.1	7.6	7.9
Net debt/equity	73.0	70.1	67.0	63.4
Net debt/EBITDA (x)	3.7	3.5	3.3	3.1
CF from operations/net debt	15.3	19.5	22.3	23.7
Per share data (EUR)				
EPS reported (fully diluted)	0.37	0.45	0.43	0.44
HSBC EPS (fully diluted)	0.34	0.40	0.43	0.44
DPS	0.27	0.27	0.27	0.29
Book value	5.62	5.79	5.95	6.12

Valuation data

Year to	12/2014a	12/2015e	12/2016e	12/2017e
EV/sales	2.2	2.2	2.1	2.0
EV/EBITDA	9.6	9.1	8.6	8.3
EV/IC	1.1	1.1	1.1	1.0
PE*	19.0	15.9	15.0	14.6
P/Book value	1.1	1.1	1.1	1.0
FCF yield (%)	1.7	4.3	5.4	5.9
Dividend yield (%)	4.2	4.2	4.2	4.5

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 23 Jul 2015

Premium yield reflected

- Earnings momentum for IBE remains strong (as showed at H1 results) mainly thanks to QE and euro depreciation
- Premium yield is justified given the asset mix and better capital structure but is priced in at the current share price while uncertainty due to general elections in Spain may emerge during H2
- Hold rating reiterated (TP increased to EUR6.7 from EUR6.3)

Investment thesis

We reiterate our Hold rating on Iberdrola ("IBE"). The company released its H1 results on July 22 and we have updated our financial forecasts and valuation to reflect better performance from the international assets (mainly driven by forex effect due to euro depreciation versus other international currencies). In our view, IBE presents a solid and encouraging equity story driven by solid exposure to regulated or quasi-regulated assets (we estimate that 72% of the EBITDA in 2016e would be derived from these businesses), organic growth from regulated capex (UK network, US expansion and renewable additions) and improved balance sheet (net debt to EBITDA ratio is expected to fall towards 3.5x in 2015 versus the 4.2x reference at the end of 2011).

Nevertheless, we struggle to find relevant upside at the current price (IBE has achieved an absolute increase of 17% in its share price in the last 12 months). On the one hand, we outline the premium yield already reflected by the stock (trading at an implied dividend yield of 4.2%for 2015e-2016e versus the sector still offering >5%) assuming the current dividend floor of EUR0.27/share. Even if we were to assume a 15% increase in that floor DPS (to EUR0.31/share requiring EUR250m of greater dividend cash outflow), the implied yield of the stock at the current price would be 4.8%, below some peers. Likewise, other valuation metrics are far from appealing, with the stock trading close to 15x PE and 9.0x EV/EBITDA on 2016 estimates. On the other hand, we remain concerned about the political news-flow that could emerge in Spain during H2 given the upcoming general elections. Despite the constant international diversification of IBE, we calculate that around 40% of the EBITDA is linked to Spanish assets. The risk premium associated to these assets could spike depending on the political developments.

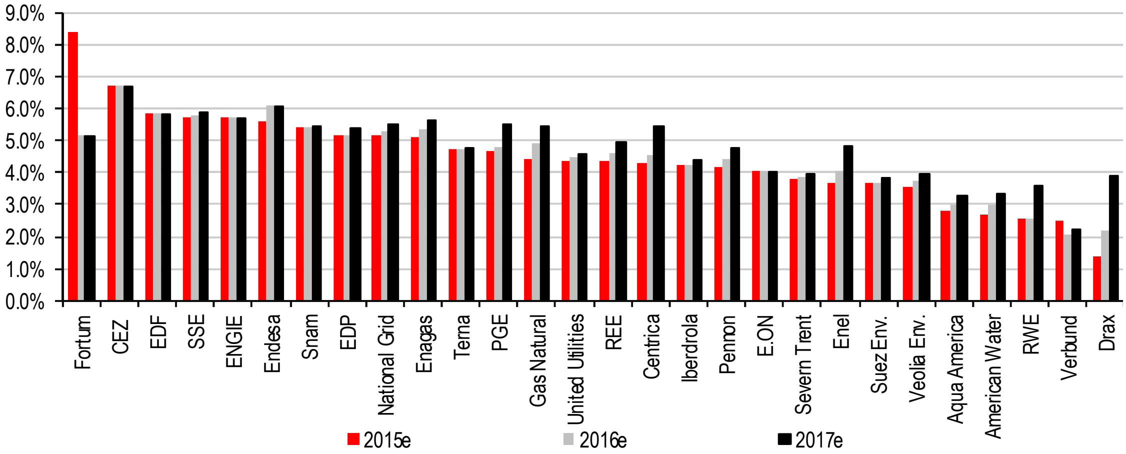
Hold rating, TP increased to EUR6.7/share from EUR6.3/share

We have revised our target price up to EUR6.7/share from EUR6.3/share (6.6% increase). The increase in the fair value is derived from higher DCF and SOP value (higher earnings mainly driven by forex effect partially offset by higher net debt) and also higher implied yield (we have increased our target yield to 4.25% from 4.50% reflecting a premium to the sector). As our new fair value TP implies 4% upside, we reiterate our Hold rating.

Premium yield already reflected

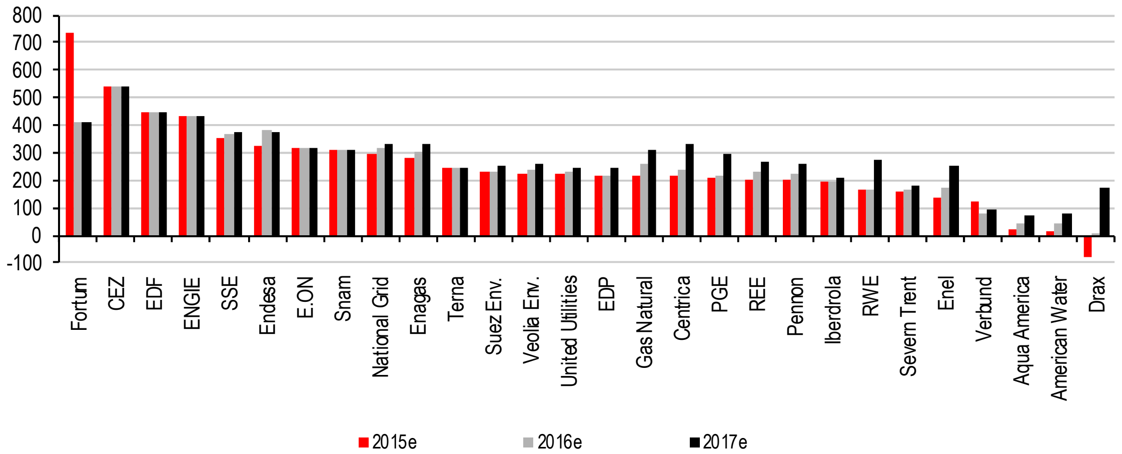
As we have highlighted in several reports on the utility industry in the last months, dividend yield has become a more relevant metric for utilities taking into account the minimum sovereign yields offered by the European countries on the back of the QE monetary policy. At the current price, IBE does not screen well when compared to the absolute yield offered by other peers in the sector. Even though a premium yield could be justified versus some peers thanks to the relevant exposure to regulated assets, balance sheet improvement (providing security to the dividend) and growth opportunities linked to the international assets, we highlight in the chart below that similar profile companies (such as fully regulated network companies or other integrated stocks) offer on average 100 bps of greater yield.

Dividend yield of European utilities



Source: HSBC estimates

Dividend yield minus domestic 10Y bonds of European utilities (bp)



Source: HSBC estimates

If we adjust the implied dividend yield offered by the stock with the domestic 10Y bond yield reference, we also find lower spread attraction relative to some peers. Iberdrola offers a c200 bps of positive spread versus the Spanish government yields (10Y reference), while many other peers approach c300 bps of spread. On our estimates, we assume a flat DPS of EUR0.27/share for 2015e and 2016e, with an increase to EUR0.29/share and EUR0.31/share in 2017e and 2018e respectively assuming a 65% pay-out ratio. Even though the leverage improvement of the company may open a window for a quicker increase in the dividend, we do not foresee a potential scenario where the dividend can be significantly increased taking into account the desire to speed up growth capex in the near future.

Forex helping earnings

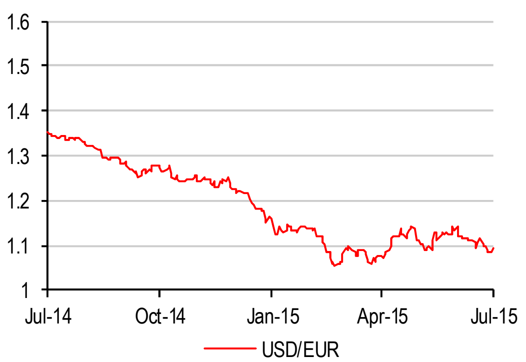
Iberdrola reported a solid set of results during H1 mainly thanks to currency movements (euro depreciations versus dollar and British pound). Adjusted EBITDA grew 9.1% yoy but only 1.4% of the growth was linked to greater activity while the balance (7.7% of the growth) was due to forex movements. IBE's UK and US activities account for roughly 45% of the EBIT for this year (i.e. not including the assets of UIL Holding that are expected to be consolidated during 2016e). We calculate that a 10% appreciation in the US and UK currencies versus the Euro provides an EPS delta of around 4.5% for 2015e, taking into account also the greater financial expenses linked to the non-euro denominated debt.

IBE net income sensitivity to USD and GBP currency appreciation

	2015e
% of EBIT in USD	24%
% of EBIT in GBP	23%
US dollar appreciation	10%
GBP pound appreciation	10%
new implied group EBIT in EURm	200
% of debt in USD	21%
% of debt in GBP	27%
USD appreciation	10%
GBP appreciation	10%
Implied higher financial expenses in EURm	49
Net impact in EURm (assuming 25% tax rate)	114
Current net income estimate in EURm	2,524
Delta to net income (in %)	**4.5%**

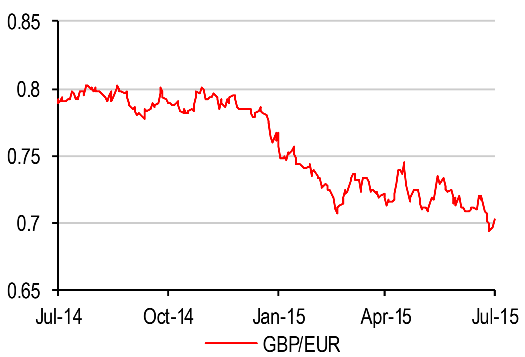
Source: HSBC estimates

USD/EUR



Source: Thomson Reuters Datastream

GBP/EUR



Source: Thomson Reuters Datastream

In the last 12 months, the US dollar has appreciated 20% versus the euro while the British pound has strengthened around 8%. This performance has helped IBE to increase its EBITDA from the international assets in the US and in the UK and also its net earnings. In contrast, the strengthening of these currencies has increased the net debt of the group (around EUR1.6bn or 6% versus the net debt accounted 12 months ago).

But… are we getting close to the end of FX help?

Our currency research team expects limited additional upside in the USD and GBP currencies versus the euro. As we detail in the table below, our currency estimates project a marginal appreciation of the dollar versus the euro in the next quarters but a turnaround in 2016e. In the case of the British pound, our in house estimates point to a minor strengthening of the euro versus the pound versus the current spot reference.

HSBC EUR currency estimates

	Spot exchange rate	HSBC estimate			
		Q3 2015	Q4 2015	2015	2016
USD/EUR	1.09	1.05	1.05	1.07	1.09
GBP/EUR	0.70	0.72	0.72	0.72	0.75

Source: HSBC estimates

Therefore, we think that the solid earnings momentum unveiled by Iberdrola in the last quarters may persist during H2 taking into account positive annual comparisons, but the impact for next year onwards may stop as we do not anticipate additional weakness in the European currency.

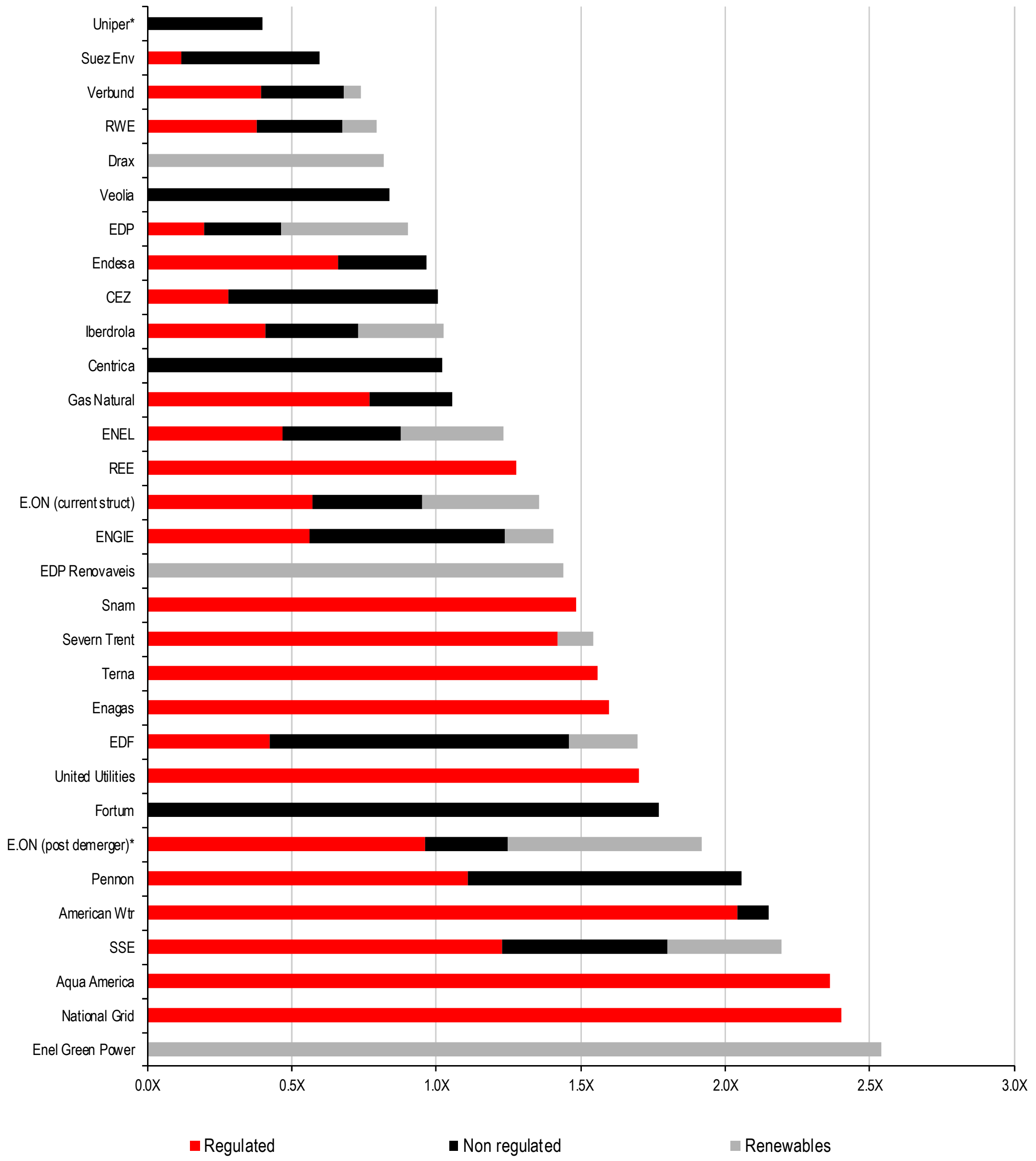
Approaching a new capex cycle

During the conference call after the release of the H1 results, Iberdrola's CEO (Mr. Galan) commented that the group is ready for a step up in the capex profile in order to sustain a greater medium-term operational growth. During February 2014, IBE presented a new business plan that envisaged EUR9.6bn of capex for the period 2014-16 (54% of it linked to maintenance and 46% of it linked to growth projects). That reference implied an annual capex of EUR3.2bn (quite in-line with our current assumptions). The majority of the expected investments were supposed to be focused in regulated or quasi-regulated assets. Almost 60% of the capex was primary focused on network assets (UK, USA and Spain) while the renewable division was supposed to take 22% of the accumulated capex.

Therefore, IBE has now hinted that a potential 25% increase in the annual capex could be on the agenda (from the current EUR3.2bn annual reference to a figure closer to EUR4.0bn). It was unclear if the company was assuming the consolidation of UIL Holding in the US (asset to be acquired before the end of this year) as the main driver for the step up in the capex outlook, but we think that there could be additional room for additional investments without putting in danger the leverage metrics. We calculate that Iberdrola can increase its annual capex outlook to around EUR5.5bn without breaking the 3.5x ceiling ratio assuming the consolidation of UIL Holdings, our current dividend estimates and no significant deterioration in the current exchange rates. The exposure to different regulated businesses (where capex is still well in demand) and to the renewable industry secures, in our view, greater capex opportunities for the company.

When compared to the sector, IBE is currently investing at a slower pace. We calculate that for the period 2015e-17e, the company will show a ratio of around 1.0x in terms of capex to depreciation. Fully regulated networks and other integrated peers are investing a figure closer to 1.5x, which is more rational to sustain earnings growth (and therefore dividends) over the medium term. We calculate that an increase in the annual capex to EUR5.5bn would increase the ratio to around 1.5x-1.6x from the current 1.0x reference, moving to the first quartile of the sector peers.

Utilities capex/depreciation 2015e-17e



Source: HSBC estimates; * Figures for E.ON (post demerger) and Uniper are based on 2016e-17e

Acquisition of UIL holding still underway

Iberdrola announced at the end of February of this year the proposed acquisition of UIL Holding in the US market (see report *Reshuffling US portfolio via acquisition of UIL Holding*, 26 February 2015). IBE highlighted that they were expecting to close this deal during the last quarter of this year. So far the company has obtained 4 different regulatory approvals, but they are still missing a few others. For instance, the Connecticut Public Utilities Regulatory Authority (CT PURA) preliminarily rejected the proposed acquisition asking for greater benefits for bill payers. On top of this one, the Massachusetts Department of Public Utilities may also analyse and need to approve the proposed acquisition and integration.

IBE's management outlined in the conference call after the results that they remain confident about closing this deal on time. More precisely, the company believes that any regulatory hurdles from the US authorities could be addressed via negotiations. In our view, the most likely scenario is that the proposed transaction would take place albeit IBE may need to offer better conditions in terms of savings for the current utility customers.

IBE is planning the acquisition of UIL Holding for a later integration of this company into IBE's US assets (that would be quoted in the US market). The implied equity value included in the acquisition offer launched by Iberdrola for UIL Holding was almost USD3bn (and USD4.7bn in terms of EV).

Valuation of UIL Holding as presented by Iberdrola (USDm)

Equity component	2,392
Cash component	595
Total Equity Value	**2,987**
Net debt	1,708
Total EV	4,695
EV/EBITDA multiple	10.7

Source: Company data

Spanish political news-flow could create uncertainty

Although IBE has decreased its exposure to Spain in the last years thanks to greater international diversification, the Spanish assets are still a relevant portion of the group. We calculate that taking into account the generation and supply assets, the distribution networks assets and the domestic renewable assets, almost 40% of the EBITDA is still linked to Spain.

Spain will hold general elections during Q4 2015 (no specific date has been announced yet). During May this year, there were also regional and municipal elections that showed a significant decrease in votes for the conservative party (which currently has a qualified majority in Parliament). Even though we still have a few months from now to the election date, the polls are suggesting a very fragmented vote that may require different partnerships between the parties in order to form a stable government. After the municipal elections we already saw several partnerships with different left parties (such as PSOE or Podemos).

Different outcomes in the general elections would have different implications for Iberdrola (and also for whole Spanish electricity industry) assuming different political scenarios:

- Conservative government remains in place. In our view, that would be the best scenario for Iberdrola as the market would not envisage any potential change in the regulatory terms that were implemented in the last few years following the electricity energy reform which implied several claw-backs for the revenues of the Spanish activities.

- Change in government led by left parties. This scenario would create greater uncertainty for the whole industry because any new government would be an unknown quantity in terms of existing regulatory frameworks in the electricity industry particularly if a new government implements new energy policies like the support of renewable assets, tariff decreases in the regulated bills or changes in the remuneration of the clean generation assets (hydro and nuclear fleets).

The expected political news-flow is therefore a relevant item to consider in the next few months. The release of the manifestos from the different parties and the election promises by the different parties could create uncertainty for the industry we conclude.

Reviewing estimates after H1 results

We have updated our financial estimates on Iberdrola after the H1 results (released last week). For 2015e, we have increased our EBITDA estimates by 3% and our adjusted net profit estimate by 5.5%. For 2016e and 2017e, we have on average increased our EBITDA estimates by 2.5% while we have on average increased our adjusted net income estimates by 3.2%.

Summary of changes in financial estimates

EURm	2015e	2016e	2017e
EBITDA (EURm)			
Revised	7,334	7,666	7,855
Previous	7,146	7,441	7,691
% change	2.6%	3.0%	2.1%
Adjusted Net Profit (EURm)			
Revised	2,524	2,670	2,749
Previous	2,393	2,565	2,685
% change	5.5%	4.1%	2.4%
EPS (EUR/share)			
Revised	0.40	0.43	0.44
Previous	0.38	0.41	0.43
% change	5.5%	4.1%	2.4%
DPS (EUR/share)			
Revised	0.27	0.27	0.29
Previous	0.27	0.27	0.28
% change	0.0%	0.0%	2.4%

Source: HSBC estimates

In terms of DPS, we have left unchanged our estimates for 2015e and 2016e (assuming the current DPS floor of EUR0.27/share), but for 2017e we have lifted our DPS by 2% in-line with the EPS increase (from 2017 onwards we assume a 65% pay-out ratio).

The key changes in our financial forecasts are explained by:

- Strengthening of currencies in the US and UK businesses
- Slightly higher profitability in the domestic distribution assets driven by lower opex
- Better performance in the Mexican generation assets
- Lower tax rate at group level thanks to lower corporate taxes in Spain and in UK (for 2015e IBE is accounting a non-recurrent tax gain of EUR220mn reported during Q2).
- Partially offsetting the above we now assume slightly higher financial expenses (slightly lower cost by slightly higher net debt on currency movements) and lower contribution from equity associates.

The breakdown of the EBITDA estimates to 2017e is detailed below:

Iberdrola EBITDA estimates - segment forecasts (EURm)

EURm	2012a	2013a	2014a	2015e	2016e	2017e
Networks	2,945	3,108	3,236	3,518	3,616	3,665
Liberalised	2,347	2,040	2,292	2,217	2,335	2,414
Renewables	1,620	1,573	1,326	1,503	1,612	1,676
Brazil	827	578	300	296	303	322
Non-energy	44	7	-17	-20	-21	-22
Others	-57	-100	-172	-180	-180	-200
Total	**7,727**	**7,205**	**6,965**	**7,334**	**7,666**	**7,855**

Source: HSBC estimates

Valuation and risk

Valuation – TP increased to EUR6.7/share from EUR6.3/share

We have increased our fair value target price to EUR6.7/share from EUR6.3/share (6.6% increase). The higher EPS estimates and the strengthening of the dollar and the pound versus the euro have increased our DCF and SOP valuations by 10% and 7% respectively (partially offset by a higher net debt estimate). We have also improved our yield valuation, assuming now a target yield of 4.25% versus 4.50% before.

Our new fair value TP of EUR6.7 is based on the rounded average of: DCF (EUR7.9) with 25% weighting, sum-of-parts (EUR6.3 with 10% discount) with 25% weighting and yield valuation (EUR6.4 assuming 4.25% implied yield) with 50% weighting. We maintain our Hold rating on the stock as our target price of EUR6.7 implies an upside of 4%.

Summary of Iberdrola valuations: EUR6.7/share target price

Methodology	Valuation weighting	Revised	Previous	% change
DCF value	25%	7.9	7.2	9.7%
SOP value at 10% discount	25%	6.3	5.8	7.3%
Yield	50%	6.4	6.0	5.9%
Target price		**6.7**	**6.3**	**6.6%**

Source: HSBC estimates

Our DCF is based on WACC of 5.8% (unchanged) derived from cost of equity of 7.7% (risk free rate of 3.0%, country risk premium of 5.5%, and beta of 0.85) and pre-tax cost of debt of 4.2%. Our terminal growth rate is 1%. Our DCF value has increased thanks to higher EPS estimates and greater margins in the terminal value.

Our SOP value is EUR6.3 after applying a 10% discount. The SOP value has mainly increased on higher valuation for the UK and US businesses. The 10% discount reflects a similar discount versus peers reflecting conglomerate status and political risks.

A yield valuation provides a value of EUR6.4 assuming a 4.25% target yield versus the 2015e DPS. We have reduced the target yield from 4.50% to 4.25% in order to reflect IBE's premium asset mix and potential dividend growth on higher organic capex and improved capital structure.

HSBC

Iberdrola DCF valuation

	EURm
DCF value (core operations)	74,000
Associates, ST marketable assets, other assets	5,574
EV asset side	**79,574**
Financial debt	-25,499
Quasi-debt (pension and other provisions)	-4,057
Minorities and other liabilities	-743
Total liabilities	-30,299
Value of equity	**49,275**
No. of shares (m)	6,240
DCF value per share (EUR)	**7.9**

Source: HSBC estimates

Iberdrola SOP valuation

Business	EV (€mn)	€/share	% Weight	Comment
IBE Domestic Activities	27,027	4.3	36.6	Implied EV/EBITDA 2016E of 9x (premium versus peers on quality assets)
IBE Latam Activities	4,254	0.7	5.8	DCF (WACC@ 10.2%) and capacity multiples. Implied EV/EBITDA 2015E of 6.2x
Scottish Power	14,478	2.3	19.6	Implied EV/EBITDA 2015E of 9.2x
Iberdrola Renewables	13,947	2.2	18.9	Implied EV/EBITDA 2015E of 9.8x
Energy East	8,500	1.4	11.5	30% premium over average RAB to 2017. Implied EV/EBITDA 2015E of 9.9x
Non-energy and financial stakes	5,574	0.9	7.6	
Total Enterprise Value	**73,779**	**11.8**	**100.0**	**Implicit EV/EBITDA 15E of 9.3x**
Net Debt	(25,499)			Estimate for end 2015E (assumes partial securitisation of the historical deficit)
Hybrid debt	(536)			Treated as 100% Equity by Iberdrola
Other Liabilities (Pension fund and others)	(4,148)			Estimate for 2015E
Minority Interest	(207)			Estimate for 2015E
Pending deficit securitization	0			Assuming pending tariff deficit to be securitized by the end of 2015E
SOTP (€/share)	**43,389**	**6.9**		
SOTP Value at 10% discount (€/share)		**6.3**		**Implied P/E 16E of 16.1x**

Source: HSBC estimates

Iberdrola Yield based valuation

	EUR
DPS 2015e (EUR/share)	0.270
Implied DY (in %)	4.25%
Value per share based on implied yield (EUR/share)	**6.4**

Source: HSBC estimates

Risks

Upside risks

Improvement in the domestic regulatory environment; favourable political climate in Spain and the UK; strengthening of international currencies versus the EUR; improvement in LatAm economies where Iberdrola is mainly present in Brazil and Mexico; ongoing improvement in the sovereign outlook in Spain, successful disposal of a minority stake in the domestic network assets re-investing the proceeds in higher returns projects and continued improvement in the cost of debt of the group.

Downside risks

Deterioration of the European sovereign outlook; political instability in Spain after the general elections scheduled for H2 2015; unexpected regulatory changes for the regulated assets of the group; introduction of power rationing in Brazil; additional decrease in commodities and power prices.

Disclosure appendix

Analyst Certification

The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Pablo Cuadrado, Adam Dickens and Verity Mitchell

Important disclosures

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From 23rd March 2015 HSBC has assigned ratings on the following basis:

The target price is based on the analyst’s assessment of the stock’s actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation or resumption of coverage, change in target price or estimates).

Upside/Downside is the percentage difference between the target price and the share price.

Prior to this date, HSBC’s rating structure was applied on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock’s domestic or, as appropriate, regional market established by our strategy team. The target price for a stock represented the value the analyst expected the stock to reach over our performance horizon. The performance horizon was 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, had to exceed the required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock was expected to underperform its required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands were classified as Neutral.

*A stock was classified as volatile if its historical volatility had exceeded 40%, if the stock had been listed for less than 12 months (unless it was in an industry or sector where volatility is low) or if the analyst expected significant volatility. However, stocks which we did not consider volatile may in fact also have behaved in such a way. Historical volatility was defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility had to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Rating distribution for long-term investment opportunities

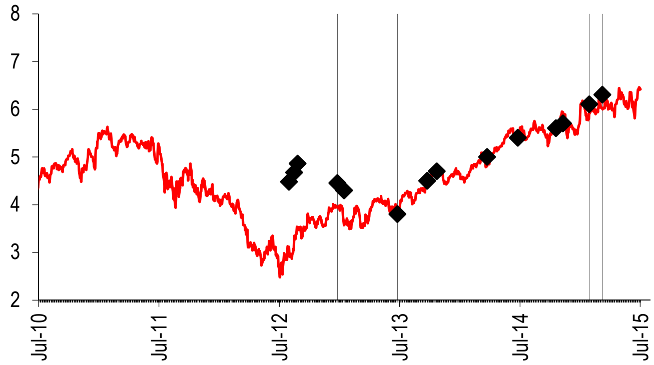
As of 24 July 2015, the distribution of all ratings published is as follows:

Buy	42%	(29% of these provided with Investment Banking Services)
Hold	42%	(28% of these provided with Investment Banking Services)
Sell	16%	(18% of these provided with Investment Banking Services)

For the purposes of the distribution above the following mapping structure is used during the transition from the previous to current rating models: under our previous model, Overweight = Buy, Neutral = Hold and Underweight = Sell; under our current model Buy = Buy, Hold = Hold and Reduce = Sell. For rating definitions under both models, please see "Stock ratings and basis for financial analysis" above.

Share price and rating changes for long-term investment opportunities

Iberdrola (IBE.MC) Share Price performance EUR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Overweight	Neutral	15 January 2013
Neutral	Underweight	17 July 2013
Underweight	Neutral	19 February 2015
Neutral	Hold	31 March 2015
Target Price	**Value**	**Date**
Price 1	4.48	22 August 2012
Price 2	4.67	06 September 2012
Price 3	4.86	17 September 2012
Price 4	4.45	15 January 2013
Price 5	4.30	05 February 2013
Price 6	3.80	17 July 2013
Price 7	4.50	15 October 2013
Price 8	4.70	14 November 2013
Price 9	5.00	15 April 2014
Price 10	5.40	17 July 2014
Price 11	5.60	10 November 2014
Price 12	5.70	01 December 2014
Price 13	6.10	19 February 2015
Price 14	6.30	31 March 2015

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
IBERDROLA	IBE.MC	6.42	24-Jul-2015	2, 5

Source: HSBC

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