



| Electric Utilities | **Rating upgrade** | Spain |

# Endesa SA

Becoming more constructive as risks are priced in; upgrading to Buy

**Buy** (from Hold)

Price 02/03/16 **€16.6**  
12m target **€18.5**  
Upside to TP **11.2%**  
12m f'cast div **€1.09**  
12m TSR **17.8%**

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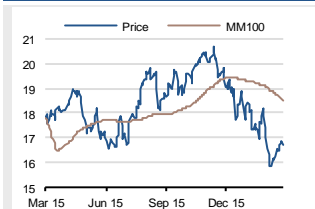
**Sector stance**

Underweight  
**Preferred stock**  
Enel, Suez, Enagas, E.ON  
**Least preferred stock**  
SSE, Centrica

**Investment trigger**

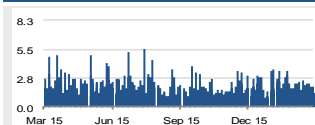
Undervalued  
High dividend yield

**Share price performance**



Source: SG Cross Asset Research/Equity

**Volume**



Source: SG Cross Asset Research/Equity

**Share data**

<b>RIC ELE.MC, Bloom ELE SM</b>			
52-week range		20.6-15.7	
EV 16 (€m)		22,985	
Mkt cap. (€m)		17,611	
Free float (%)		30.0	
<b>Performance (%)</b>	<b>1m</b>	<b>3m</b>	<b>12m</b>
Ordinary shares	-6.6	-15.9	-8.0
Rel. Eurofirst 300	-8.3	-5.1	7.0

**Update** We are revising our estimates to factor in lower commodity and power price assumptions. We are also factoring in the closure of domestic coal plants by 2020 as well as new interconnections. On top of this, we expect some pressure on supply margins in the coming years, though we do not expect them to collapse. All in all, we are increasing our EPS forecasts for 2016 by 3.3% and cutting it by 7.1% and by 3.0% for 2017 and 2018, respectively.

**SG view** We are upgrading Endesa to Buy from Hold as in our view: **A)** Lower power prices and pressure on supply margins are already priced in and the market knows that. **B)** We think that in an attempt to offset some of the headwinds it might face in the coming years, Endesa has set aside too many provisions (and if that were the case, it would be a positive surprise for the market). We estimate that the buffer represents 6% of our 2017 and 2018 EPS estimates, though we are not factoring it in. **C)** We expect the Spanish utilities' decision (in 2016) to close domestic coal plants by 2020 to highlight the positive dynamics of the Spanish power market after 2019 (power prices increasing to €50/MWh by 2021 and to €60/MWh by 2025). We think Endesa is a good way to invest in investors' expectations about market price performance. **D)** We see room for an improvement in the dividend policy to prevent a DPS decrease on lower earnings in 2017e. Balance sheet strength can support a 5% DPS growth policy and the acquisition of EGPW Spanish assets (putting DY at c.7.0%).

**How we value the stock** Our TP is €18.5/sh (unchanged), derived from an SOP valuation (with a DCF for each activity using a WACC of 5.8% for liberalized activities and 4.5% for regulated activities). Generation and supply activities account for 39% of our EV, while distribution assets account for 60% (see details inside the report).

**Events, catalysts & risks to price target, rating & recommendation** Downside risks are lower power prices and supply margins than forecast and any unexpected regulatory review regarding distribution assets that may cut the current allowed return. Risks on the upside are higher power and supply margins than estimated and better operating performance than expected in the distribution grids. Catalysts are the formation of a government in Spain and potential acquisition of assets.

<b>Financial data</b>	12/15	12/16e	12/17e	12/18e	<b>Ratios</b>	12/15	12/16e	12/17e	12/18e
Revenues (€bn)	20.3	17.5	14.7	14.8	P/E (x)	17.7	15.3	17.2	17.2
EBIT margin (%)	7.9	9.6	10.1	10.0	FCF yield (/EV) (%)	8.9	7.1	5.0	6.5
Rep. net inc. (€bn)	1.09	1.15	1.02	1.03	Dividend yield (%)	15.5	14.2	12.5	13.7
EPS (adj.) (€)	1.03	1.09	0.97	0.97	Price/book value (x)	2.14	1.94	1.96	1.96
Dividend/share (€)	2.82	2.36	2.08	2.28	EV/revenues (x)	1.24	1.31	1.56	1.53
Payout (%)	274	217	216	236	EV/EBIT (x)	15.8	13.7	15.5	15.2
Interest cover (x)	8.59	10.9	9.88	10.1	EV/IC (x)	1.6	1.5	1.5	1.6
Net debt/equity (%)	48	44	45	41	ROIC/WACC (x)	1.2	1.4	1.2	0.0
Previous EPS		1.05	1.04	na	EPS CAGR 15-18e: -2.06%				

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## Main changes

### Main changes

(Buy, TP €18.5) vs. (Hold, TP €18.5)	2016					2017				
	old	new	%chg.	Cns.	SG vs Cns.	old	new	%chg.	Cns.	SG vs Cns.
EBITDA	3,042	3,098	1.8%	3,196	-3.1%	2,983	2,922	-2.0%	3,067	-4.7%
EPS	1.05	1.09	3.3%	1.18	-8.0%	1.04	0.97	-7.1%	1.09	-11.3%
DPS	1.05	1.09	3.6%	1.18	-8.0%	1.04	0.97	-7.2%	1.09	-11.3%

Source: SG Cross Asset Research/Equity

### Estimates change

€m	2016e	2017e	2018e
<b>EBITDA</b>			
New	3,098	2,922	2,943
Old	3,042	2,983	2,980
%Chg	1.8%	-2.0%	-1.3%
<b>EPS</b>			
New	1.09	0.97	0.97
Old	1.05	1.04	1.00
%Chg	3.3%	-7.1%	-3.0%
<b>DPS</b>			
New	1.09	0.97	0.97
Old	1.05	1.04	1.00
%Chg	3.6%	-7.2%	-3.0%

Source: SG Cross Asset Research/Equity

### Peer comparison

Company	EV/EBITDA FY16E	EV/EBITDA FY17E	EBITDA CAGR 15-17E(%)	PE FY16E	PE FY17E	EPS CAGR 15-17E(%)	Div Yield% FY16E	Div Yield% FY17E	DPS CAGR 15-17E(%)	ND/EBITD A FY16E	ND/EBITD A FY17E
Iberdrola	10.7x	11.0x	2.9%	15.6x	16.2x	-2.5%	4.8%	4.5%	-2.5%	3.7x	4.0x
<b>Endesa *</b>	<b>7.5x</b>	<b>7.9x</b>	<b>-1.9%</b>	<b>13.4x</b>	<b>15.4x</b>	<b>-3.0%</b>	<b>6.5%</b>	<b>5.8%</b>	<b>-3.0%</b>	<b>2.4x</b>	<b>2.5x</b>
Gas Natural SDG	7.2x	7.0x	0.2%	10.9x	10.4x	4.7%	5.9%	6.3%	4.2%	2.8x	2.7x
EDP	9.2x	8.9x	-5.3%	12.4x	12.1x	-3.1%	6.5%	6.5%	0.0%	4.7x	4.4x
Enel	6.8x	6.8x	-2.4%	13.4x	12.9x	-6.6%	4.3%	4.9%	10.5%	2.7x	2.7x
Engie	7.5x	7.8x	-2.9%	13.0x	14.6x	-4.1%	4.9%	4.9%	-16.3%	4.2x	4.4x
EDF	5.3x	5.9x	-4.3%	5.9x	8.3x	-23.5%	12.9%	12.9%	0.0%	4.3x	4.8x
E.ON	7.6x	7.0x	-2.2%	12.3x	10.2x	6.9%	6.0%	6.6%	4.9%	5.1x	4.7x
RWE	7.4x	5.9x	-0.5%	9.9x	7.1x	-10.9%	4.7%	5.7%	9.5%	4.5x	3.2x
Centrica	8.4x	8.1x	-2.9%	14.9x	14.4x	-2.0%	5.8%	5.8%	0.0%	2.2x	1.9x
SSE	10.8x	11.0x	4.1%	13.9x	14.2x	-1.4%	6.7%	6.8%	2.7%	5.1x	5.4x

Source: SG Cross Asset Research/Equity \* Endesa ratios adjusted to a level of 2.5x ND/EBITDA

## Upgraded to Buy

We are upgrading Endesa to Buy from Hold as we think that the main risks are priced in, while Endesa offers a good way to invest in the dynamics of mid-term Spanish power price changes, together with its still an attractive dividend yield. Our TP is €18.5/sh (unchanged) as lower estimates in generation have been offset by higher value in the distribution unit and lower net debt by the end of the year than expected.

The main risks that we have been highlighting are now priced in, and in our view the market is well aware of them: 1) low power prices should take their toll in the coming years, 2) Endesa will use part of its resources to acquire generation assets (highly likely Enel Green Power's Spanish assets) and 3) supply margins are likely to be under pressure.

However we highlight the following issues: **A) Power prices** should start to recover from 2019 onwards due to market dynamics (closure of domestic coal plus nuclear and CCGT plants, increasing its role in setting marginal price), **B) Despite the EGPW acquisition**, the balance sheet is still strong enough to support an attractive dividend policy. **C) The company has a buffer to partially offset** the impact of lower power prices as it set aside high provisions in 2015 (for cost cutting and to reverse some of those taken when needed). **On top of this** our analysis shows that the closure of domestic coal plants in 2020 could have an impact on EPS of between 5% and 10% for the next five years. In essence:

- Is Endesa **exposed to power prices**? Yes. Each €1/MWh has an impact on EPS of 3.0%. **However**, the share price factors in the forward curve, while Endesa is a good way to invest in the recovery in Spanish power prices (which is not linked to a commodities recovery).
- Is Endesa **exposed to supply margins**? Yes. Each €1/MWh reduction in the supply margin (equivalent to 20% cut) would have an impact on EPS of 6%. **However**, we are already cutting our supply margin assumptions by 18% as a result of expected regulatory and market pressure. On top of that, Endesa's exposure to liberalized households (the segment with the highest margins and the one under regulator/politicians' scrutiny) is the smallest among peers (only 9% of its portfolio), limiting the risk.
- Is Endesa **unlikely to issue a special dividend**? Yes. **However**, in our view Endesa will pursue an attractive dividend policy despite any headwinds from low power prices (even increasing the payout above 100% again). But we do not expect to see a big special dividend as we think Endesa will pursue stronger growth through acquisitions, which in the case of generation assets will try to offset the closure of domestic coal plants and from 2022 the gradual phase-out of nuclear plants.

We think that this year the decision regarding domestic coal plants will lead investors to realize that the Spanish power market can drive power prices up independent of a recovery in commodity prices (though from 2019 onwards). Endesa is a good way to invest in this issue. It also offers an attractive dividend yield and the potential to partially offset the impact of power prices with cost cutting/provision reversals.

In this report, we mark to market power prices and cut supply margins, but we do not factor in a reversal of any provisions in 2017/2018. We are increasing our EPS for 2016e by 3.3% (better generation margins) and cutting our EPS by -7.1% and -3.3% for 2017 and 2018 due to lower power prices.

## A good way to invest in a Spanish power price recovery midterm

We have already pointed out that Endesa's earnings are affected by power prices. In the sector report, we show our new power price estimates, which reflect the commodities forward curve for the next two years. In this respect, we do not expect a recovery in power prices and Endesa's earnings should be impacted by that (which is already known by investors and factored into our estimates).

However, Endesa's generation assets have a long useful life of over 16 years on average (not considering any life extension of the nuclear plants). Hence, Endesa should be able to capture the recovery in power prices in Spain that we are forecasting. What it is important is that the price recovery we expect would come mainly from a change in market dynamics and not from a recovery in commodity prices.

In essence, the closure of domestic coal plants and gradual closure of nuclear plants means that CCGT plants should occupy a greater role in setting the marginal price despite our assumption of new renewable capacity (700MW/y) and higher interconnection with France.

In the table below we show our estimate for the generation and supply unit, which includes non-mainland generation assets (regulated).

### Generation & Supply unit

€ m	2016 e	2017 e	2018 e	2019 e	2020 e	2021 e	2022 e	2023 e	2024 e	2025 e
<b>Output (GWh)</b>	<b>60,989</b>	<b>61,294</b>	<b>61,601</b>	<b>61,909</b>	<b>55,718</b>	<b>55,829</b>	<b>55,941</b>	<b>56,053</b>	<b>53,250</b>	<b>50,588</b>
Nuclear	25,756	25,756	25,756	25,756	25,756	25,756	23,125	23,125	12,766	12,766
Hard Coal - Imported	14,198	14,198	14,198	14,198	14,198	14,198	14,198	14,198	14,198	14,198
Hard Coal - Domestic	8,984	8,469	8,469	8,448	845	845	845	845	845	0
CCGT	4,607	5,841	6,147	6,476	7,889	8,000	10,743	10,855	18,411	16,594
Hydro & other	7,444	7,031	7,031	7,031	7,031	7,031	7,031	7,031	7,031	7,031
<b>EBITDA</b>	<b>1,311</b>	<b>1,075</b>	<b>1,082</b>	<b>1,181</b>	<b>1,298</b>	<b>1,399</b>	<b>1,455</b>	<b>1,483</b>	<b>1,729</b>	<b>1,674</b>
Generation	464	240	271	361	500	589	634	655	880	820
Supply	471	458	431	438	450	460	468	472	491	494
Non Mainland	376	377	380	382	347	350	353	355	357	359
<b>Avg selling price (€/MWh)</b>	<b>52.4</b>	<b>46.8</b>	<b>46.1</b>	<b>48.1</b>	<b>52.4</b>	<b>55.7</b>	<b>57.9</b>	<b>58.8</b>	<b>65.7</b>	<b>65.8</b>

Source: SG Cross Asset Research/Equity

Our forecasts are calculated using our proprietary model, where we use forward curves (next table) for all the major commodities that are an input for generation processes (e.g. coal, gas, CO<sub>2</sub>, etc.), whilst volumes produced by the generating units and spreads (dark and spark) are the output from our model.

### Commodities assumptions

	2017e	2018e	2019e	2020e
Coal (\$/t)	38.0	38.0	38.0	41.0
Oil (Brent, \$/bbl)	44.0	47.4	49.5	51.0
Uranium (€/MWh)	1.6	1.7	1.7	1.7
CO <sub>2</sub> (€/MWh)	5.5	5.7	5.9	6.0

Source: SG Cross Asset Research/Equity, Bloomberg

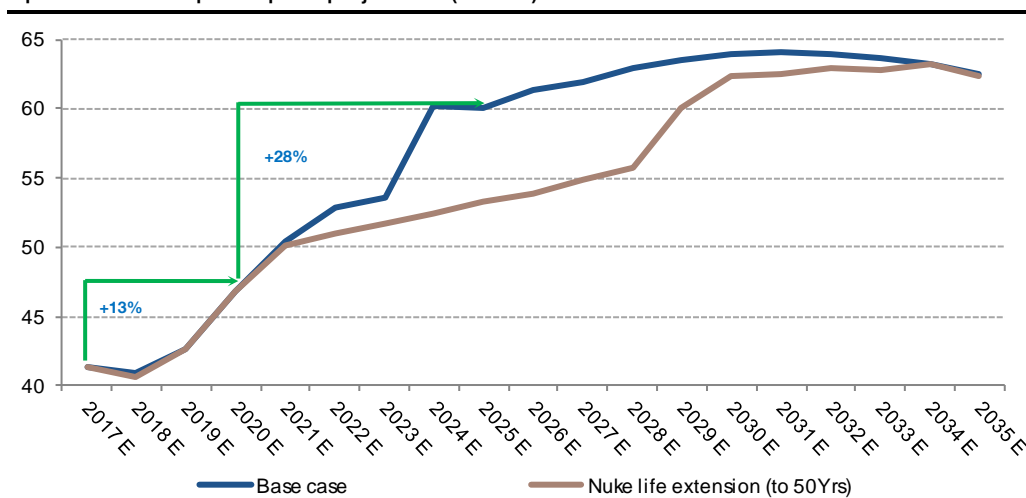
In essence, in our base case we expect power prices to rise by 13% between 2017 and 2020. We see an even bigger jump through 2025 as power prices should leap 28%. However, if

asset life for nuclear stations in Spain is lengthened to 50 years, the increase in power prices could still be substantial, but less than in our base case.

The increase to 2020 would remain the same, but the change from 2020 to 2025 would decline to a mere 4%. Interestingly, towards the end of the next decade power prices should converge anyway.

We find these developments interesting, because the increase in prices in our model is not driven by an increase in input costs, but rather by a change in the structure of the market. This actually places the Spanish wholesale market in a special position compared to many other European markets.

**Spain – baseload power price projections (€/MWh)**



Source: SG Cross Asset Research/Equity

It may sound blasphemous to talk about a rise in power prices in Spain (indeed this is the case for most European markets), as we are accustomed to oversupply in generation. But capacity closures are going to affect the market in our view.

It should take time for power prices to rise as any tangible effect would only be felt come 2020, so this may be too far away for investors to worry about. In reality though, whether capacity closes (coal) or not, we should know this year: the simple mechanics of power markets (marginal pricing system) should ensure that this will translate into higher power prices, so investors will no longer discount ‘flat forever’ power prices as seems to be the case now.

We expect domestic coal (c.5GW) to be gradually phased out from 2016 onwards with almost complete decommissioning by 2020. This is due to the application of the IED directive that requires polluting units that have not upgraded their equipment to close down<sup>1</sup> by 2020 (next chart, left). We see wind capacity continuing to grow in Spain (500-750MW additional capacity p.a. in our model), but this is not enough to offset the effect of the closure of domestic coal plants on power prices.

<sup>1</sup> See the Industrial Emissions Directive (IED), 2010/75/EU, Article 32.

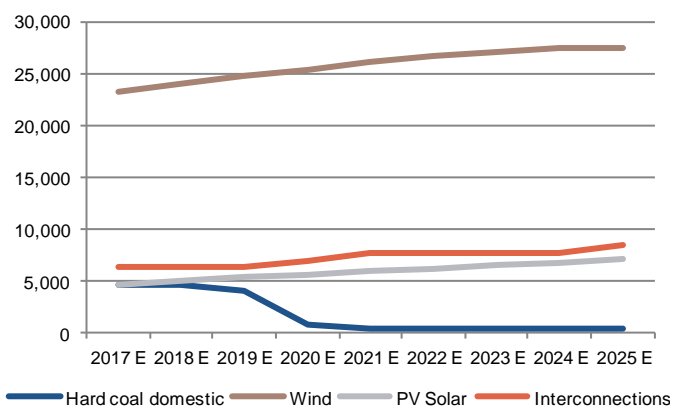
We further assume that the project to strengthen the interconnection with France by REE (+1.4GW by 2020-21) will be completed and that power will flow from France to Spain and the interconnection will be fully utilised. Compared to our power price estimates for 2017, 2020 baseload should be c.€6/MWh higher, but it would be even higher if new interconnections were not being built.

In essence, power prices rise in our model because as domestic coal closes down gas units that are so far out of the merit order would come back into the equation and start to set the pool price, at least during certain times of the year, and this is the chief reason for a rise in power prices and hence prices.

A question we are often asked is whether coal units that burn imported coal cannot take up the volumes freed up by the closure of domestic coal units. The answer is no, and that is because imported coal units are already running at full throttle, and they have very little wiggle room to increase current production. So again, gas fed units need to come back on line, thus increasing the overall cost of producing electricity in Spain.

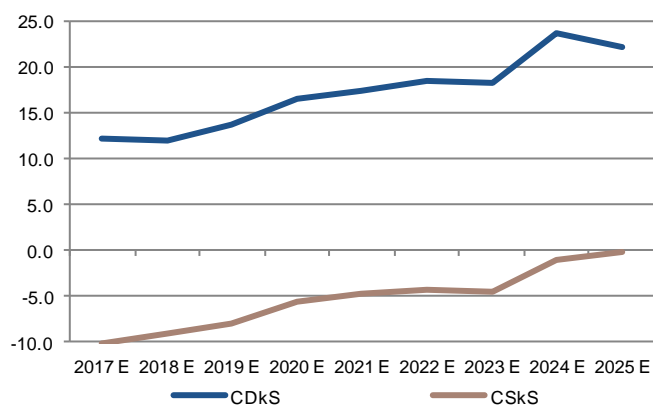
Investments in coal stations for the NOX and SOX emission cut, according to Endesa, could cost up to €200m per unit. Current clean dark spreads for imported coal generating units are clearly attractive (next chart, right) but domestic coal units are just a shade above breakeven. We think therefore that it is not economically profitable to invest in cutting emissions of the units and think that closing down the plants is a better option.

**Spain – relevant changes in installed capacity (MW)**



Source: SG Cross Asset Research/Equity; (\*) based on imported coal prices

**Spain – clean dark(\*) and spark spreads (€/MWh)**



Source: SG Cross Asset Research/Equity; (\*) based on imported coal prices

Besides, investing and extending the life of coal assets would probably be a suboptimal choice since this would depress power prices post 2020. For a utility such as Endesa that has a variety of technologies within its generation portfolio, this would not maximise the value.

The Spanish government has tried to subsidise the required investments, thus reducing the financial burden to utilities. However, the EC has declared that such subsidies constitute state-aid and thus are not allowed. This actually plays very well in the utilities' hands, as the closure should push power prices higher.

If we are right, the Spanish power market could be an exception within Europe. A parallel can be drawn with the German market where nuclear will close down for good between 2020-22. However, the impact of these closures is not as big as in Spain since the existing nuclear industry is just c.8GW out of 195GW+ total installed capacity.

Indeed the modelled recovery for power prices in Spain only starts in 2019 and some may believe that this is not going to act as a catalyst for the stock. However, Endesa and the other coal operators will have to decide by the end of this year how to proceed: if they decide not to invest, then domestic coal will inevitably have to close and the pure mechanics of the power market should lead to higher power prices.

## Less risk than it looks like in supply margins

We have gone through the supply margins issue in our sector report ([Iberian utilities: risks ahead but there's a joker in the deck](#)), so in this section we will offer a concentrated version.

- 1. Pressure is expected and already factored into our numbers:** We see more competition coming in supply margins as power prices remain low. And on top of this we do not rule out the regulator putting pressure on supply margins to households (according to regulator: €22/MWh). Hence we are forecasting a cut in margins (18% in 2017e vs 2015e level).
- 2. We see the main risk in supply margins to households:** As we explain in the sector report, one of the main conclusions obtained from our analysis of the companies' commercial offers (and the market analysis by regulators) is what looks like potentially high margins obtained in the liberalised household segment (€22/MWh vs €7.3/MWh of regulated customers). We also think that the likely populist mood of the new government will make them focus on that segment.
- 3. Endesa has relatively small exposure to households:** Endesa (see chart below) has limited exposure to the liberalised household segment as it only accounts for 9% of its portfolio. That makes Endesa have lower average margins than peers and hence less exposure to both such a market and regulatory pressure.
- 4. Margins unlikely to collapse:** A 25% reduction in the supply margin in the liberalised households segment would imply a cut of €0.5/MWh in the average margins for Endesa with an impact of 3% on EPS (which already reflects a reduction in the average supply margin). If market or regulatory pressure becomes significant, we think that many small suppliers will exit the market and in a short time the whole market will again be in the hands of just a few names (with all the potential consequences that can be imagined).

Hence, while the pressure on supply margins must be kept in mind, we nevertheless think this risk is manageable. Endesa already noted some margin compression in its most recent strategic review.

In the table/charts below we show the main data for the supply unit, the breakdown of the supply clients' portfolio and the gross margins according to the commercial offers of the companies. We also show the gross margins estimated by the regulator in 2013 and 2014.

### Supply unit main data

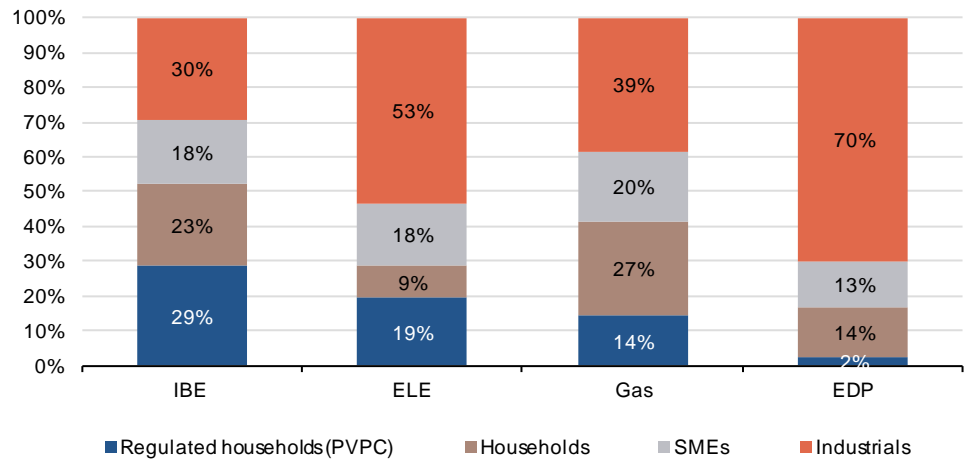
€m	2015 e	2016 e	2017 e	2018 e	2019 e	2020 e
<b>Energy sales (Gwh)</b>	<b>93,928</b>	<b>93,928</b>	<b>94,867</b>	<b>95,342</b>	<b>95,818</b>	<b>96,297</b>
Regulated households	16,560	16,601	16,850	16,893	16,935	16,977
Contracts linked to pool	23,482	23,482	23,717	23,835	23,955	24,074
Contracts fixed price	53,886	53,845	54,300	54,614	54,929	55,246
<b>Unitary margins (€/MWh)</b>	<b>6.0</b>	<b>5.1</b>	<b>4.9</b>	<b>4.9</b>	<b>4.9</b>	<b>5.0</b>

Regulated households	7.3	7.3	7.3	7.3	7.3	7.3
Contracts linked to pool	5.0	4.7	4.1	4.1	4.3	4.7
Contracts fixed price	6.0	4.5	4.5	4.5	4.5	4.5

<b>EBITDA Supply</b>	<b>562</b>	<b>480</b>	<b>468</b>	<b>469</b>	<b>475</b>	<b>488</b>
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Source: SG Cross Asset Research/Equity

**Electricity supply breakdown by client segment**



Source: SG Cross Asset Research/Equity

**Gross margin according to current commercial offers**

€/MWh	IBE	ELE	Gas	EDP
Households <10KW	7.0	7.0	7.0	7.0
Households >10KW	23.6	24.4	24.6	20.0
S&M ent.	9.4	10.4	11.6	11.1
Industrial	2.0	2.0	2.0	2.0
<b>Avg weighted by segment</b>	<b>9.9</b>	<b>6.5</b>	<b>10.8</b>	<b>5.9</b>

Regulated households (PVPC)	29%	19%	14%	2%
Households	23%	9%	27%	14%
SMEs	18%	18%	20%	13%
Industrials	30%	53%	39%	70%

Source: SG Cross Asset Research/Equity

**Gross margins according to CNMC report**

€/MWh	2013	2014
<b>Avg selling price</b>		
Households <10KW	185	195
Households >10KW	189	197
S&ME.	150	153
Industrial	92	90
<b>Avg cost of energy</b>		
Households <10KW	87	89
Households >10KW	94	96
S&ME.	86	87
Industrial	61	60



**Gross Margin**

Households <10KW	9 - 14	12 - 18
Households >10KW	16 - 22	19 - 25
S&ME.	9 - 15	10- 17
Industrial	0 - 5	0 - 6

Source: CNMC 8 October 2015 report

## No special dividend but attractive DPS growth still possible

Endesa management has pointed out that in the absence of non-organic growth opportunities, a special dividend may materialise. However, we think that this scenario is unlikely, firstly because the likely closure of domestic coal plants will make them acquire renewable assets (or other generation assets) in order to not remain in an overly long supply position vs generation output. Secondly, as long as the low power price environment remains, it is wise to retain balance sheet strength. Thirdly, if Endesa eventually puts its stake up for sale, we think that the price will likely be higher if the company's balance sheet is underleveraged.

However, **the absence of a special dividend is not mutually exclusive of an improvement in the dividend policy** (should earnings decrease due to low power prices). In essence, considering a ND/EBITDA ratio of 3.5x for regulated assets, 1.0x for liberalised generation and no leverage at all for supply as "reasonable", the ND/EBITDA level would be 2.5x and 2.7x in 2016e and 2017e respectively. That leaves **c.€4.0bn for re-leveraging** (not taking any acquisition into consideration as the assets to be acquired would have EBITDA as well).

All in all we estimate that the change to the dividend policy of **"5% DPS growth"** would require €185m and €242m of additional dividends in 2017e and 2018e (cash payment). Considering the buffer vs the "reasonable" leverage level – even considering the acquisition of Enel Green power assets (EV €1.8bn) – there is room to accomplish it without stressing the credit metrics. In such a case, the **dividend yield would be above 6.8% and 7.1% respectively.**

This could be perceived as unsustainable and the market would not see it as positive as the payout would be above 100% (though just 105% and 110%, respectively). However, we estimate a recovery of power prices in 2019 and hence earnings recovery will make the payout affordable from that point onwards. And even Endesa would have enough muscle to invest in the life extension of nuclear plants as the ND/EBITDA would still be just 1.8x by 2022.

### Comparison of dividend policy scenarios

€m	2016 e	2017 e	2018 e
<b>Current</b>			
DPS	1.09	0.97	0.97
%Chg	6%	-11%	0%
Payout	100%	100%	100%
<b>Total dividends</b>	<b>1,150</b>	<b>1,023</b>	<b>1,026</b>
<b>Dividend yield</b>	<b>6.5%</b>	<b>5.8%</b>	<b>5.8%</b>
<b>"DPS 5% growth policy"</b>			
DPS	1.09	1.14	1.20
%Chg	6%	5%	5%
Payout	100%	105%	110%

<b>Total dividends</b>	<b>1,150</b>	<b>1,207</b>	<b>1,268</b>
<b>Dividend Yield</b>	<b>6.5%</b>	<b>6.8%</b>	<b>7.1%</b>

Source: SG Cross Asset Research/Equity

*EGPW acquisition is not likely to enhance EPS very much – but it should preserve supply margins*

We estimate that the acquisition of the EGPW Spanish assets will not enhance EPS very much due to the high D&A charges and the increase in financial expenses, and because the contribution to affiliates from EGPW Spain will disappear once it is fully consolidated. We value EGPW Spanish assets at €1.87bn (EV value) – however Endesa already owns 40% of the equity of Enel Green Power Spain.

**Impact of EGPW Spanish assets acquisition**

€m	2016 e	2017 e	2018 e
<b>EBITDA</b>			
Currently est.	3,098	2,922	2,943
Post transaction	3,313	3,141	3,165
%chg	7.0%	7.5%	7.5%
<b>EPS</b>			
Currently est.	1.09	0.97	0.97
Post transaction	1.09	0.98	0.98
%chg	0.4%	1.0%	1.3%
<b>Net Debt</b>			
Currently est.	3,997	4,023	3,717
Post transaction	5,646	5,672	5,366
<b>ND/EBITDA</b>			
Currently est.	1.3x	1.4x	1.3x
Post transaction	1.7x	1.8x	1.7x

Source: SG Cross Asset Research/Equity

All in all we estimate that EPS could increase by 0.4% in 2016e (full-year impact) despite a positive impact on EBITDA of +7%. However, another issue that support the transaction is the fact that with Endesa controlling those renewable assets, it can internalise and integrate the energy asset in the generation & supply unit. That means (in the event of the closure of domestic coal plants to partially offset the loss of the output from the domestic coal plants by 2020), the energy lost by domestic coal plants should be 7.6TWh vs. 3.8TWh of energy coming from Enel Green's Spanish power assets.

In essence, getting more generation assets (e.g. EGPW assets in Spain), Endesa can better control the risk of being long in supply vs generation, materially reducing the potential impact on the average supply margins.

## Estimates review and valuation

We are revising our estimates in order to reflect our new power price assumptions for the Spanish market, the closure of the majority of domestic coal plants in 2020, and our new assumptions for energy supply margins.

All in all we are increasing our EBITDA in 2016e by 1.8% and cutting it by -2.0% and by -1.3% in 2017e and 2018e respectively. Regarding EPS we are increasing our estimate for 2016e by +3.3% and cutting it by -7.1% and by -3.0% in 2017e and 2018e respectively.

The reason for the increase in estimates in 2016e is due to better generation margins as the energy already hedged by the company reflects a higher price than we had previously forecast. The cut in the following years is due to our new power price estimates and supply margin expectations.

Regarding the DPS, we are factoring in a 100% payout policy despite having pointed out in this report that an improvement in the dividend policy cannot be ruled out due to balance sheet strength.

We want to highlight that in our view Endesa has taken a highly conservative approach on provisions for 2015. It has taken a highly conservative approach which provides room for further cost-cutting measures or for provisions to be reversed in the coming years – which may partially offset the impact of lower power prices in the results. We estimate that €150m has been provisioned for that reason in 2015. That could have an impact of c.6% on our estimated net profit for 2017e and 2018e.

### Estimates revision

€m	2016 e	2017e	2018e
<b>EBITDA</b>			
New	3,098	2,922	2,943
Old	3,042	2,983	2,980
%Chg	1.8%	-2.0%	-1.3%
<b>EPS</b>			
New	1.09	0.97	0.97
Old	1.05	1.04	1.00
%Chg	3.3%	-7.1%	-3.0%
<b>DPS</b>			
New	1.09	0.97	0.97
Old	1.05	1.04	1.00
%Chg	3.6%	-7.1%	-3.0%

Source: SG Cross Asset Research/Equity

### EBITDA breakdown

€m	NEW			OLD			Diff%		
	2016 e	2017 e	2018 e	2016 e	2017 e	2018 e	2016 e	2017 e	2018 e
<b>Generation</b>	<b>1,311</b>	<b>1,075</b>	<b>1,082</b>	<b>1,260</b>	<b>1,236</b>	<b>1,175</b>	<b>4.0%</b>	<b>-13.0%</b>	<b>-8.0%</b>
Liberalized	464	240	271	405	380	317	14.5%	-36.8%	-14.7%
Supply	471	458	431	480	481	480	-2.0%	-4.7%	-10.2%
Non Mainland	376	377	380	374	375	378	0.5%	0.5%	0.5%
<b>Distribution</b>	<b>1,787</b>	<b>1,797</b>	<b>1,811</b>	<b>1,729</b>	<b>1,739</b>	<b>1,755</b>	<b>3.3%</b>	<b>3.3%</b>	<b>3.2%</b>
<b>Others &amp; Adj.</b>	<b>(50)</b>	<b>(50)</b>	<b>(50)</b>	<b>(50)</b>	<b>(50)</b>	<b>(50)</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>
<b>Cost cutting</b>	<b>50</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>-50.0%</b>	<b>0.0%</b>	<b>0.0%</b>
<b>Total EBITDA</b>	<b>3,098</b>	<b>2,922</b>	<b>2,943</b>	<b>3,039</b>	<b>3,025</b>	<b>2,980</b>	<b>1.9%</b>	<b>-3.4%</b>	<b>-1.3%</b>

Source: SG Cross Asset Research/Equity

**Regarding our valuation**, we are setting a TP of €18.5/sh (unchanged) derived from a SOP valuation (DCF for each activity using WACC of 5.8% for liberalised activities and 4.5% for regulated activities). In our EV value, generation and supply activities account for 39% of the total while distribution assets account for 60%. We retain our TP despite as lower estimates in generation have been offset by higher value in the distribution unit and lower net debt by the end of the year than was previously expected.

In generation we use a DCF factoring the remaining useful life of the plants, our assumptions in power prices and commodities (for fuel costs), and the regulatory measures currently in place (generation taxes). Regarding energy supply we consider there to be no variation in the Endesa market share going forward and we apply a multiple of 7.0x EBITDA to the average EBITDA expected between 2016e and 2018e. In distribution, we use a DCF model factoring in the net asset value and the current remuneration framework (6.5% allowed return) with a remaining useful life of 23 years.

**SOP**

€m	EV	%EV	Criteria	WACC	EV/EBITDA		
					16 e	17 e	18 e
<b>Generation &amp; Supply</b>	<b>9,227</b>	<b>37%</b>	<b>DCF</b>	<b>5.8%</b>	<b>7.0x</b>	<b>8.6x</b>	<b>8.4x</b>
Generation Mainland	2,836	11%	DCF	5.8%	6.1x	11.8x	11.3x
Generation Non Mainland	3,217	13%	8.5X EBITDA	n.m.	8.6x	8.5x	8.1x
Power Supply	3,174	13%	7.0X EBITDA	n.m.	7.0x	6.9x	7.1x
<b>Distribution</b>	<b>15,289</b>	<b>61%</b>	<b>DCF</b>	<b>4.5%</b>	<b>8.6x</b>	<b>8.1x</b>	<b>8.4x</b>
Distrib. Grid	12,287	49%	RAB model	4.5%	8.6x	8.6x	8.5x
Other Distrib. Services	3,001	12%	DCF	n.m.	8.6x	8.3x	8.3x
<b>Other&amp; Adj.</b>	<b>375</b>	<b>2%</b>	<b>7.5x EBITDA</b>	<b>n.m.</b>	<b>7.5x</b>	<b>7.5x</b>	<b>7.5x</b>
<b>EV</b>	<b>24,891</b>	<b>100%</b>			<b>8.0x</b>	<b>8.5x</b>	<b>8.5x</b>
Net Debt	(4,334)						
Provisions	(2,944)						
Fin. Assets	1,687						
Regulatory receivables	292						
<b>Equity value</b>	<b>19,589</b>						
<b>TP (Eur/sh)</b>	<b>18.5</b>						

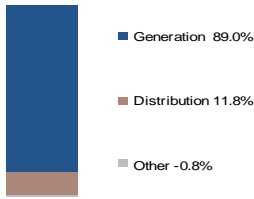
Source: SG Cross Asset Research/Equity

**Risks to our valuation.** Downside risks are lower power prices and output than previously expected, lower supply margins than previously forecast and any unexpected regulatory review of distribution assets that may cut the current allowed return. Risks on the upside are related to higher power and supply margins than previously estimated and a better operating performance than had been expected in the distribution grids.

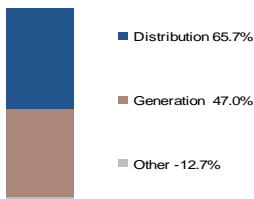
Regarding the sensitivities –each €1/MWh variation in power prices has a 3.0% impact on our EPS. Each €1/MWh variation in the energy supply margin has a 6% impact on our EPS. Each variation of 0.5% in the allowed return in distribution assets has an impact of 5% on EPS.

**Endesa SA**

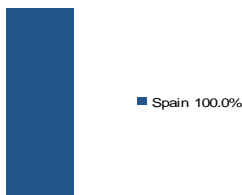
**Sales/division 15**



**EBIT/division 15**



**Sales/region 15**



**Major shareholders (%)**

Valuation (€m)	12/11	12/12	12/13	12/14	12/15	12/16e	12/17e	12/18e
Nb. of shares basic year end/outstanding	1,059	1,059	1,059	1,059	1,059	1,059	1,059	1,059
Share price (average)	19.8	14.7	18.3	24.8	18.2	16.6	16.6	16.6
Average market cap. (SG adjusted) (1)	20,931	15,523	19,430	26,281	19,310	17,611	17,611	17,611
Restated net debt (-)/cash (+) (2)	-11,073	-9,158	-4,368	-5,436	-4,334	-3,997	-4,023	-3,717
Value of minorities (3)	5,388	5,716	6,248	0	0	0	0	0
Value of financial investments (4)	2,792	2,949	4,283	1,979	1,979	1,979	1,979	1,979
Other adjustment (5)	4,168	4,381	3,627	3,518	3,506	3,356	3,319	3,281
EV = (1) - (2) + (3) - (4) + (5)	38,768	31,829	29,390	33,257	25,171	22,985	22,974	22,631
P/E (x)	nm	nm	nm	67.3	17.7	15.3	17.2	17.2
Price/cash flow (x)	6.2	5.2	5.0	4.9	6.5	6.9	8.5	7.3
Price/free cash flow (x)	29.8	nm	8.40	13.8	10.1	11.8	17.7	13.2
Price/book value (x)	1.09	0.76	0.95	3.06	2.14	1.94	1.96	1.96
EV/revenues (x)	1.32	1.04	1.37	1.55	1.24	1.31	1.56	1.53
EV/EBITDA (x)	9.6	8.4	9.1	10.8	8.3	7.4	7.9	7.7
Dividend yield (%)	nm	nm	20.3	19.2	15.5	14.2	12.5	13.7
<b>Per share data (€)</b>								
SG EPS (adj.)	-1.06	-1.10	-1.56	0.37	1.03	1.09	0.97	0.97
Cash flow	3.18	2.82	3.70	5.09	2.82	2.42	1.97	2.29
Book value	18.2	19.2	19.4	8.10	8.53	8.59	8.47	8.48
Dividend	-0.70	-1.56	3.73	4.76	2.82	2.36	2.08	2.28
<b>Income statement (€m)</b>								
Revenues	29,445	30,724	21,515	21,512	20,299	17,483	14,714	14,813
Gross income	7,763	7,619	5,602	5,651	5,583	5,592	5,435	5,475
EBITDA	4,024	3,796	3,216	3,090	3,039	3,098	2,922	2,943
Depreciation and amortisation	-2,612	-2,587	-2,418	-1,618	-1,441	-1,417	-1,438	-1,459
EBIT	1,412	1,209	798	1,472	1,598	1,680	1,485	1,484
Impairment losses	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net interest income	-622	-641	-350	-166	-186	-154	-150	-147
Exceptional & non-operating items	119	-12.0	37.0	-6.00	-6.00	0.00	0.00	0.00
Taxation	-1,159	-1,053	-1,075	-296	-301	-397	-334	-334
Minority interests	-809	-737	-1,064	-651	-4.00	-4.44	-3.89	-3.91
Reported net income	-1,029	-1,175	-1,625	3,337	1,086	1,150	1,023	1,026
SG adjusted net income	-1,124	-1,165	-1,655	391	1,092	1,150	1,023	1,026
<b>Cash flow statement (€m)</b>								
EBITDA	4,024	3,796	3,216	3,090	3,039	3,098	2,922	2,943
Change in working capital	-1,175	580	894	346	-788	217	-309	10
Other operating cash movements	514	-457	-188	737	737	-748	-531	-528
Cash flow from operating activities	3,363	2,985	3,922	5,392	2,988	2,567	2,083	2,424
Net capital expenditure	-2,661	-3,646	-1,608	-1,413	-1,084	-1,080	-1,086	-1,093
Free cash flow	702	-661	2,314	3,979	1,904	1,487	996	1,332
Cash flow from investing activities	0	0	0	0	0	0	0	0
Cash flow from financing activities	-1,077	-633	1,796	-16,194	-805	-1,150	-1,023	-1,026
Net change in cash resulting from CF	-375	-1,294	4,110	-12,215	1,099	337	-26	306
<b>Balance sheet (€m)</b>								
Total long-term assets	49,210	50,012	45,965	25,969	24,660	24,345	24,016	23,673
of which intangible	3,013	2,772	2,290	428	428	428	428	428
Working capital	-6,560	-7,457	-8,487	-5,673	-5,673	-5,826	-5,645	-5,651
Employee benefit obligations	826	826	826	827	809	769	759	749
Shareholders' equity	19,291	20,369	20,521	8,575	9,036	9,100	8,973	8,976
Minority interests	5,388	5,716	6,248	0	3	7	11	15
Provisions	3,342	3,555	2,801	3,308	3,234	3,074	3,034	2,994
Net debt (-)/cash (+)	-11,073	-9,158	-4,368	-5,436	-4,334	-3,997	-4,023	-3,717
<b>Accounting ratios</b>								
ROIC (%)	2.9	2.6	1.9	5.1	7.4	8.2	7.4	-2.5
ROE (%)	-5.6	-5.9	-7.9	7.3	12.3	12.7	11.3	11.4
Gross income/revenues (%)	26.4	24.8	26.0	26.3	27.5	32.0	36.9	37.0
EBITDA margin (%)	13.7	12.4	14.9	15.0	15.0	17.7	19.9	19.9
EBIT margin (%)	4.8	3.9	3.7	7.9	7.9	9.6	10.1	10.0
Revenue yoy growth (%)	-5.6	4.3	-30.0	0.0	-5.6	-13.9	-15.8	0.7
Rev. organic growth (%)	2.0	2.0	2.0	2.0	2.0	2.0	2.0	102.0
EBITDA yoy growth (%)	-46.2	-5.7	-15.3	-3.9	-1.7	1.9	-5.7	0.7
EBIT yoy growth (%)	-71.9	-14.4	-34.0	84.5	8.6	5.1	-11.6	0.0
EPS (adj.) yoy growth (%)	-149.4	-3.7	-42.0	123.6	179.6	5.3	-11.1	0.3
Dividend growth (%)	nm	nm	nm	27.7	-40.8	-16.3	-11.7	9.6
Cash conversion (%)	nm	85.5	nm	149.6	149.6	121.3	99.7	122.1
Net debt/equity (%)	45	35	16	48	48	44	45	41
FFO/net debt (%)	20.3	23.0	41.0	58.9	58.9	63.7	60.6	66.2
Dividend paid/FCF (%)	153.4	nm	nm	850.6	42.3	73.0	115.4	76.8

Source: SG Cross Asset Research/Equity

APPENDIX

**COMPANIES MENTIONED**

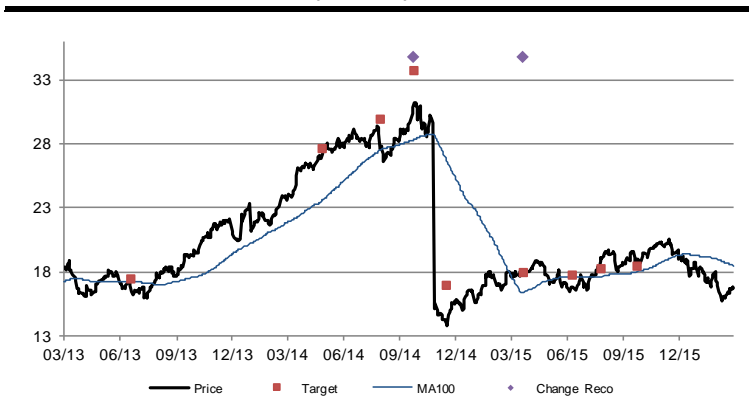
Actavis (ACT.N, No Reco )  
 Centrica (CNA.L, Sell)  
 E.ON (EONGn.DE, Buy)  
 EDF (EDF.PA, Buy)  
 EDP Renovaveis SA (EDPR.LS, Buy)  
 Enagas (ENAG.MC, Buy)  
 Endesa SA (ELE.MC, Hold)  
 Enel (ENEL.MI, Buy)  
 Enel Green Power (EGPW.MI, Buy)  
 Energias de Portugal (EDP.LS, Hold)  
 Engie (ENGIE.PA, Buy)  
 Euler Hermes (ELER.PA, No Reco)  
 Gas Natural SDG (GAS.MC, Hold)  
 Iberdrola (IBE.MC, Buy)  
 Norsk Hydro (NHY.OL, No Reco)  
 Red Electrica (REE.MC, Hold)  
 RWE (RWE.G.DE, Hold)  
 SM Energy (SM.N, No Reco)  
 SSE (SSE.L, Sell)  
 Suez (SEVI.PA, Buy)

**ANALYST CERTIFICATION**

The following named research analyst(s) hereby certifies or certify that (i) the views expressed in the research report accurately reflect his or her or their personal views about any and all of the subject securities or issuers and (ii) no part of his or her or their compensation was, is, or will be related, directly or indirectly, to the specific recommendations or views expressed in this report: **Jorge Alonso**

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**Historical Price: Endesa SA (ELE.MC)**



2013/2014	Change	2015/2016	Change
19/06/13	New Target: 17.5	23/03/15	New Rating: Hold
28/04/14	New Target: 27.7	23/03/15	New Target: 18.0
01/08/14	New Target: 30.0	11/06/15	New Target: 17.8
25/09/14	New Rating: Buy	28/07/15	New Target: 18.3
25/09/14	New Target: 33.8	25/09/15	New Target: 18.5
17/11/14	New Target: 17.0		

Source: SG Cross Asset Research/Equity

**SG EQUITY RESEARCH RATINGS** on a 12 month period

**BUY:** absolute total shareholder return forecast of 15% or more over a 12 month period.

**HOLD:** absolute total shareholder return forecast between 0% and +15% over a 12 month period.

**SELL:** absolute total shareholder return forecast below 0% over a 12 month period.

Total shareholder return means forecast share price appreciation plus all forecast cash dividend income, including income from special dividends, paid during the 12 month period. Ratings are determined by the ranges described above at the time of the initiation of coverage or a change in rating (subject to limited management discretion). At other times, ratings may fall outside of these ranges because of market price movements and/or other short term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by research management.

**Sector Weighting Definition on a 12 month period:**

The sector weightings are assigned by the SG Equity Research Strategist and are distinct and separate from SG equity research analyst ratings. They are based on the relevant MSCI.

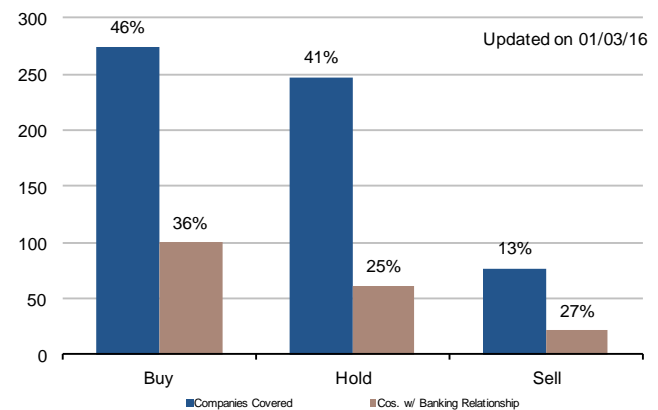
**OVERWEIGHT:** sector expected to outperform the relevant broad market benchmark over the next 12 months.

**NEUTRAL:** sector expected to perform in-line with the relevant broad market benchmark over the next 12 months.

**UNDERWEIGHT:** sector expected to underperform the relevant broad market benchmark over the next 12 months.

The Preferred and Least preferred stocks are selected by the covering analyst based on the individual analyst's coverage universe and not by the SG Equity Research Strategist.

**Equity rating and dispersion relationship**



Source: SG Cross Asset Research/Equity

All pricing information included in this report is as of market close, unless otherwise stated.

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**IMPORTANT DISCLOSURES**

EDF	SG is acting as financial advisor in the potential acquisition of Areva NP by EDF.
Enagas	SG acted as passive bookrunner for Enagas's bond issue (8y EUR).
Enel	SG makes a market in Enel warrants
Energias de Portugal	SG acted as joint bookrunner in EDP's bond issue.
Engie	SG acted as a lead structuring advisor in Engie's bond tender offer.
Engie	SG acted as passive joint bookrunner in GDF Suez's bond issue.
Gas Natural SDG	SG acted as joint bookrunner in Gas Natural's hybrid bond issue

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