



| Electric Utilities | **12m target downgrade** | Austria |

Verbund

China syndrome

Hold

Price 15/01/16 **€10.6**
12m target **€11.5**
Upside to TP **8.5%**
12m f'cast div **€0.40**
12m TSR **12.3%**

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Sector stance (Strategists)

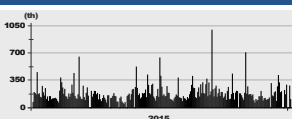
Underweight
Preferred stock
Enel, Suez, Enagas, E.ON
Least preferred stock
SSE

Share price performance



Source: SG Cross Asset Research/Equity

Volume



Source: SG Cross Asset Research/Equity

Update With our sector report (“*And now for something completely different*”) we have updated our commodity assumptions in line with forward curves as of 7 January. As a result of this, and cutting our long-term growth forecast from 0.5% to 0.0%, our TP falls from €15.00 to €11.50. We reiterate our Hold rating.

SG view When one thinks of stocks with China exposure, an Austrian hydro-generator with a grid business would, we guess, not be most people’s first choice. Yet within the utility sector, and no doubt large sections of the market, Verbund has one of the strongest correlations to the direction of commodity prices, and therefore, by extension, to China. In the YTD, API2 coal prices are down 15% and even CO2, the only pillar of strength among fuel commodities in 2015, has fallen 18%. This has left German power prices, which are Verbund’s main if not only share price driver, 16% lower at €23.6 MWh. It could be argued that given what is going on in power prices a commodity-sensitive stock like Verbund should best be avoided. However, we have shown that German power prices below €28/MWh are unsustainable in the medium term, especially in the light of further nuclear capacity closures. A capitulation of commodity prices should speed up long-overdue capacity closures. We currently value Verbund’s generation assets at €1,000/kW. About half Verbund’s installed capacity is highly attractive run-of-river plants which have changed hands at €4,500/kW in the past, admittedly when power prices were a lot higher. However, for assets with an operating life of 100 years plus, we believe a medium-term view is appropriate. We would not put too much emphasis on current depressed prices.

How we value the stock Our SOTP valuation for Verbund uses DCFs with a pre-tax WACC of 6.5% for the hydro assets and grid business, which values the latter at just above its RAB. We use the forward curve as of 7 January for power prices up to 2020. Post 2020, we assume long-run power prices of €30/MWh.

Events, catalysts & risks to price target, rating & recommendation The main catalyst is the direction of Austrian/German power prices. Risks to TP: Upside – higher coal and/or CO2 prices driving power prices higher, and/or a higher hydro coefficient; Downside – lower coal and/or CO2 prices (see p.4 for sensitivities), and/or a lower hydro coefficient.

Share data

RIC VERB.VI, Bloom VER AV			
52-week range	17.3-10.6		
EV 15 (€m)	8,929		
Mkt cap. (€m)	3,683		
Free float (%)	15.4		
Performance (%)	1m	3m	12m
Ordinary shares	-14.4	-17.4	-31.1
Rel. Eurofirst 300	-6.9	-9.2	-26.0

Financial data

	12/14	12/15e	12/16e	12/17e
Revenues (€bn)	2.83	2.89	2.78	2.71
EBIT margin (%)	16.6	19.1	14.7	12.7
Rep. net inc. (€m)	126	255	220	186
EPS (adj.) (€)	0.62	0.82	0.63	0.54
Dividend/share (€)	0.30	0.40	0.30	0.30
Payout (%)	48	49	47	56
Interest cover (x)	2.38	3.09	2.56	2.17
Net debt/equity (%)	77	69	68	67
Prev. EPS (changed as of 18/01/16)		0.82	0.73	0.68

Ratios

	12/14	12/15e	12/16e	12/17e
P/E (x)	24.2	17.2	16.8	19.8
FCF yield (/EV) (%)	4.9	6.0	5.3	4.4
Dividend yield (%)	2.0	2.8	2.8	2.8
Price/book value (x)	1.11	1.01	0.75	0.74
EV/revenues (x)	3.80	3.52	3.23	3.33
EV/EBIT (x)	23.0	18.4	22.0	26.1
EV/IC (x)	1.0	1.0	0.9	0.9
ROIC/WACC (x)	0.5	0.6	0.5	0.4
EPS CAGR 14-17e: -4.80%				

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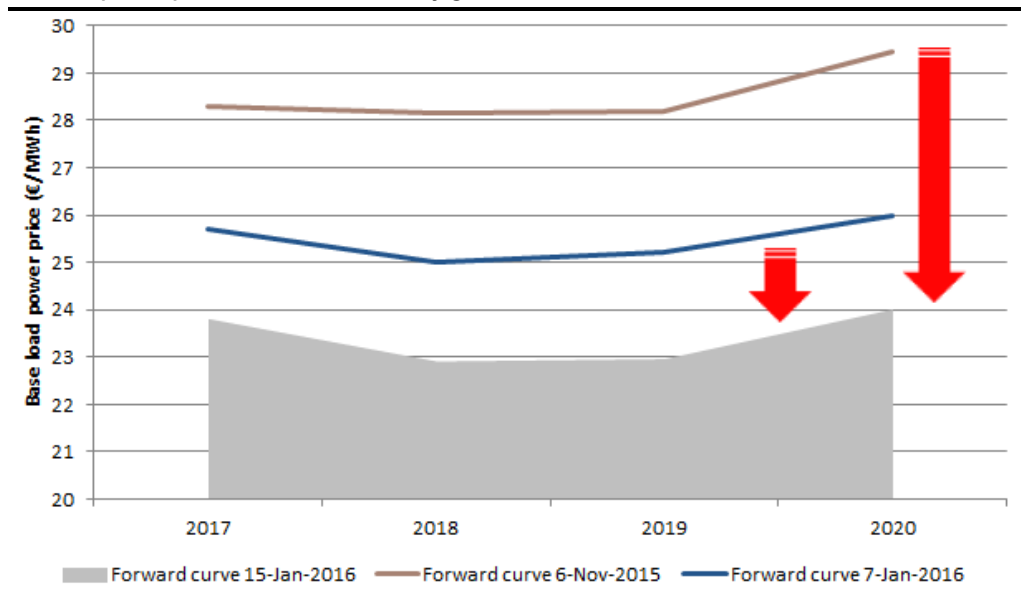
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German power curve is capitulating

Pricing anything commodity related these days is very much attempting to hit a moving target. When we updated our commodity and FX assumptions for our sector report on 7 January 2016, German power prices had already fallen about €3/MWh across the curve since our last note on Verbund (see [Balancing power boom](#), 6 November 2015). However, Chinese concerns and oversupply in the oil market have put the cat among the pigeons on anything commodity related. In the YTD, Brent Crude is down 23%, coal is down 15%, and even CO2, the single pillar of strength among fuel commodities in 2015, has fallen 18%.

German power prices – how low can they go?



Source: Bloomberg, SG Cross Asset Research/Equity

With power generation, largely from hydro, accounting for 80% of group EBITDA and a very short-term hedge profile, Verbund's earnings are highly geared to commodity prices. If we mark-to-market the forward curve to Friday's close (15 January 2016), since when power prices have lost about €2/MWh across the curve, our TP for Verbund would fall from €11.50 to €10. The table below shows the impact from our lower commodity assumptions.

Verbund forecast changes (€m, €)

	2015e	2016e	2017e	2018e	2019e	2020e
Old EBITDA	914	826	795	781	787	837
New EBITDA	914	774	716	685	695	737
% change	0.0%	- 6.3%	- 9.9%	- 12.2%	- 11.8%	- 12.0%
Old recurring EPS	0.82	0.73	0.68	0.67	0.69	0.80
New recurring EPS	0.82	0.63	0.54	0.49	0.52	0.62
% change	0.1%	- 13.1%	- 21.3%	- 26.4%	- 24.7%	- 23.1%
Old DPS	0.40	0.35	0.35	0.35	0.35	0.40
New DPS	0.40	0.30	0.30	0.25	0.25	0.30
% change	0.0%	- 14.3%	- 14.3%	- 28.6%	- 28.6%	- 25.0%

Source: SG Cross Asset Research/Equity estimates

SGe vs Bloomberg consensus (18 January 2016)

(€m, €)	2015	2016	2017	2018
EBITDA (SG)	914	774	716	685
EBITDA (consensus)	862	788	791	795
Verbund outlook	900			
SGCIB vs consensus	6.1%	(1.8%)	(9.4%)	(13.8%)
Stated Net Income (SG)	255	220	186	171
Stated Net Income (consensus)	234	224	230	241
Verbund outlook	240			
SG vs consensus	8.7%	(1.7%)	(18.9%)	(29.2%)
Adjusted Net Income (SG)	285	220	186	171
Adjusted Net Income (consensus)	255	215	220	251
Verbund outlook	270			
SG vs consensus	11.5%	2.0%	(15.3%)	(31.9%)
Adjusted EPS (SG)	0.82	0.63	0.54	0.49
Adjusted EPS (consensus)	0.73	0.61	0.65	0.70
Verbund outlook	0.78			
SG vs consensus	11.8%	3.7%	(17.5%)	(30.1%)
DPS (SG)	0.40	0.30	0.30	0.25
DPS (consensus)	0.36	0.31	0.32	0.35
SG vs consensus	10.5%	(3.2%)	(6.3%)	(27.7%)
Verbund outlook (50% payout)	0.39			

Source: Bloomberg, SG Cross Asset Research/Equity

On our new commodity-price assumptions, based on forward curves as of 7 January, we are roughly in line with consensus forecasts for 2015 and 2016, but 10-30% below for 2017 and 2018. However, with Verbund's earnings being strongly correlated to rather volatile German power prices, we think consensus estimates are likely to struggle to keep up with events.

Verbund sum-of-the-parts (€m, €)

	EBITDA 2016e	EV/EBITDA (implied)	Method	EV
Electricity	641	12.7 X	DCF	8,154
Grid	164	7.6 X	DCF	1,252
Participations	- 20	8.0 X	Multiple	- 160
Group	786	11.8 X		9,247
Net debt	2015e			- 3,735
Provisions	2015e		P/Book	- 866
Minorities	2015e	1.5 X	0.8 X	- 887
Equity accounted				263
Equity value (€m)				4,022
Shares (m)				347.42
Equity value (€)				11.60

Source: SG Cross Asset Research/Equity

Verbund summary P&L

(€m, €)	2014	2015e	2016e	2017e	2018e	2019e	2020e
Electricity	799	740	641	574	536	537	571
Grid	128	220	164	173	181	189	197
Participating interest	-25	-20	-20	-20	-20	-20	-20
Other	-41	-26	-12	-12	-12	-12	-12
EBITDA	861	914	774	716	685	695	737
- o/w Electricity	92.8%	80.9%	82.8%	80.2%	78.1%	77.3%	77.5%
Recurring EBITDA	890	868	774	716	685	695	737
Operating profit	412	488	407	345	310	314	352
Operating profit before impairments	468	552	407	345	310	314	352
Net income	126	255	220	186	171	182	214
Recurring net income	216	285	220	186	171	182	214
EPS (GAAP)	0.36	0.73	0.63	0.54	0.49	0.52	0.62
EPS (Recurring)	0.62	0.82	0.63	0.54	0.49	0.52	0.62
DPS	0.30	0.40	0.30	0.30	0.25	0.25	0.30
Payout	48%	49%	47%	56%	51%	48%	49%
German power price (€/MWh)	35.07	30.94	26.26	25.70	25.00	25.20	26.00
Verbund achieved power price (€/MWh)	39.10	34.91	30.20	27.89	26.93	26.87	27.13

Source: Company, SG Cross Asset Research/Equity estimates

Risks to recommendation, rating and target price

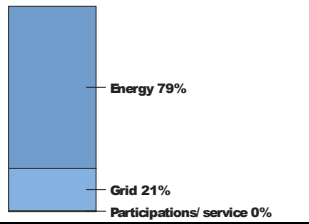
Downside risks:

- a further fall in German power prices: a fall of €1/MWh for base and peak load prices would reduce our TP by €0.70 per share. As Verbund is a hydro-power generator, a lower hydro coefficient could impact earnings.

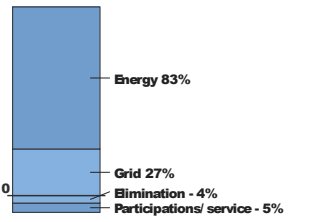
Upside risks:

- a recovery in German power prices: a rise of €1/MWh for base and peak load prices would increase our TP by €0.70 per share. As Verbund is a hydro-power generator, a higher hydro coefficient could boost earnings

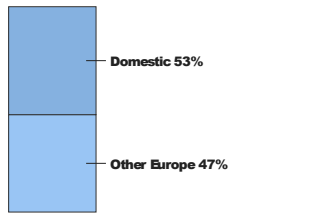
Sales/division 15



EBIT/division 15



Sales/region 15



Major shareholders (%)

Republic of Austria	51.0
Wien Strom	12.9
EVN	12.6

Verbund

Valuation (€m)	12/10	12/11	12/12	12/13	12/14	12/15e	12/16e	12/17e
Nb. of shares basic year end/outstanding	347	347	347	347	347	347	347	347
Share price (average)	27.8	26.3	18.9	16.2	15.0	14.1	10.6	10.6
Average market cap. (SG adjusted) (1)	9,661	9,136	6,567	5,627	5,217	4,912	3,683	3,683
Restated net debt (-)/cash (+) (2)	-4,234	-4,234	-3,312	-3,706	-4,060	-3,735	-3,735	-3,735
Value of minorities (3)	727	887	887	887	887	887	887	887
Value of financial investments (4)	346	263	263	263	263	263	263	263
Other adjustment (5)	654	845	845	845	845	887	931	978
EV = (1) - (2) + (3) - (4) + (5)	14,929	13,370	11,348	10,802	10,746	10,158	8,973	9,019
P/E (x)	19.5	18.5	14.5	14.6	24.2	17.2	16.8	19.8
Price/cash flow (x)	11.2	10.6	6.3	6.7	7.3	7.0	5.4	5.7
Price/free cash flow (x)	61.1	57.8	18.5	21.5	17.1	11.7	9.06	11.0
Price/book value (x)	2.16	2.04	1.47	1.14	1.11	1.01	0.75	0.74
EV/revenues (x)	4.51	4.04	3.59	3.40	3.80	3.52	3.23	3.33
EV/EBITDA (x)	14.1	na	8.9	9.3	12.1	11.7	11.6	12.6
Dividend yield (%)	2.0	2.1	3.2	6.2	2.0	2.8	2.8	2.8
Per share data (€)								
SG EPS (adj.)	1.42	1.42	1.30	1.11	0.62	0.82	0.63	0.54
Cash flow	2.48	2.48	2.98	2.42	2.07	2.02	1.98	1.85
Book value	12.9	12.9	12.8	14.2	13.5	13.9	14.2	14.4
Dividend	0.55	0.55	0.60	1.00	0.30	0.40	0.30	0.30
Income statement (€m)								
Revenues	3,308	3,308	3,160	3,178	2,826	2,885	2,776	2,710
Gross income	3,308	3,308	3,160	3,178	2,826	2,885	2,776	2,710
EBITDA	1,059	1,059	1,235	1,301	809	914	774	716
Depreciation and amortisation	-230	-230	-280	-336	-341	-362	-367	-371
EBIT	829	829	956	966	468	552	407	345
Impairment losses	0	0	-84	-929	-69	-64	0	0
Net interest income	-233	-233	-126	-120	-175	-145	-102	-95
Exceptional & non-operating items	0	0	-37	1,184	0	0	0	0
Taxation	-149	-149	-161	121	-98	-68	-77	-63
Minority interests	-84	-84	-110	-66	-54	-50	-39	-31
Reported net income	401	401	389	580	126	255	220	186
SG adjusted net income	446	446	452	384	216	285	220	186
Cash flow statement (€m)								
EBITDA	1,059	1,059	1,235	1,301	809	914	774	716
Change in working capital	32	32	-4	-7	47	-9	18	9
Other operating cash movements	-313	-313	-196	-453	-138	-205	-104	-81
Cash flow from operating activities	778	778	1,035	841	718	701	687	644
Net capital expenditure	-636	-636	-680	-579	-412	-280	-281	-308
Free cash flow	143	143	354	262	305	421	406	336
Cash flow from investing activities	-479	-479	-82	159	0	0	0	0
Cash flow from financing activities	-385	-385	-191	-208	-347	-104	-139	-104
Net change in cash resulting from CF	-721	-721	82	213	-42	317	268	232
Balance sheet (€m)								
Total long-term assets	9,722	9,722	9,782	11,092	11,167	11,084	10,999	10,935
of which intangible	0	0	0	0	0	0	0	0
Working capital	432	432	305	798	273	-319	-336	-345
Employee benefit obligations	201	201	239	352	432	453	476	500
Shareholders' equity	4,036	4,036	4,458	4,947	4,689	4,840	4,920	5,003
Minority interests	336	336	641	606	591	591	591	591
Provisions	430	430	415	365	413	434	455	478
Net debt (-)/cash (+)	-4,234	-4,234	-3,312	-3,706	-4,060	-3,735	-3,735	-3,735
Accounting ratios								
ROIC (%)	8.8	8.9	9.3	7.0	3.1	4.0	3.1	2.7
ROE (%)	11.2	9.9	9.2	12.3	2.6	5.3	4.5	3.8
Gross income/revenues (%)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
EBITDA margin (%)	32.0	32.0	39.1	40.9	28.6	31.7	27.9	26.4
EBIT margin (%)	25.1	25.1	30.2	30.4	16.6	19.1	14.7	12.7
Revenue yoy growth (%)	-5.0	0.0	-4.5	0.6	-11.1	2.1	-3.8	-2.4
Rev. organic growth (%)	-5.0	-5.0	4.4	0.6	-11.1	2.1	-3.8	-2.4
EBITDA yoy growth (%)	-16.9	0.0	16.6	5.3	-37.9	13.0	-15.3	-7.5
EBIT yoy growth (%)	-22.2	0.0	15.2	1.0	-51.6	18.0	-26.2	-15.3
EPS (adj.) yoy growth (%)	-38.1	0.0	-8.6	-15.0	-43.8	31.8	-22.8	-15.2
Dividend growth (%)	-56.0	0.0	9.1	66.7	-70.0	33.3	-25.0	0.0
Cash conversion (%)	58.7	58.7	72.2	49.0	117.2	109.5	136.2	134.3
Net debt/equity (%)	97	97	65	67	77	69	68	67
FFO/net debt (%)	16.0	16.0	28.6	35.1	13.2	18.8	15.9	14.9
Dividend paid/FCF (%)	134.1	134.1	58.8	132.4	34.1	33.0	25.6	31.0

Source: SG Cross Asset Research/Equity

APPENDIX

COMPANIES MENTIONED

E.ON (EONGn.DE, Hold)
Enagas (ENAG.MC, Buy)
Enel (ENEI.MI, Buy)
EVN (EVNV.VI, Buy)

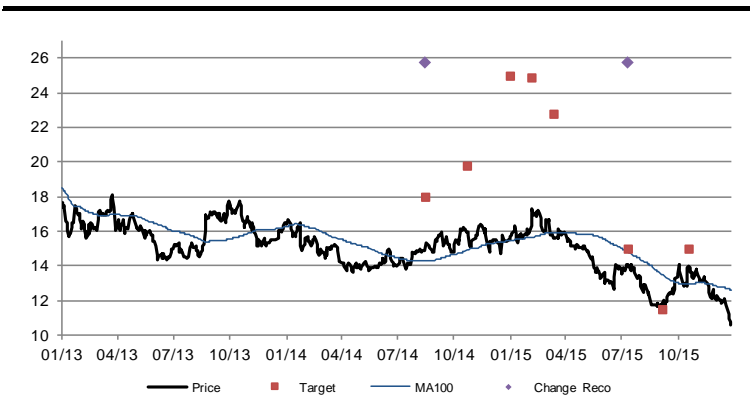
Norsk Hydro (NHY.OL, No Reco)
SSE (SSE.L, Sell)
Suez (SEVI.PA, Buy)
Verbund (VERB.VI, Hold)

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Historical Price: Verbund (VERB.VI)



2013/2014	Change	2015/2016	Change
03/09/14	New Rating: Buy	19/01/15	New Target: 25.0
03/09/14	New Target: 18.0	23/02/15	New Target: 24.9
10/11/14	New Target: 19.8	31/03/15	New Target: 22.8
		30/07/15	New Rating: Hold
		30/07/15	New Target: 15.0
		24/09/15	New Target: 11.5
		06/11/15	New Target: 15.0

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.

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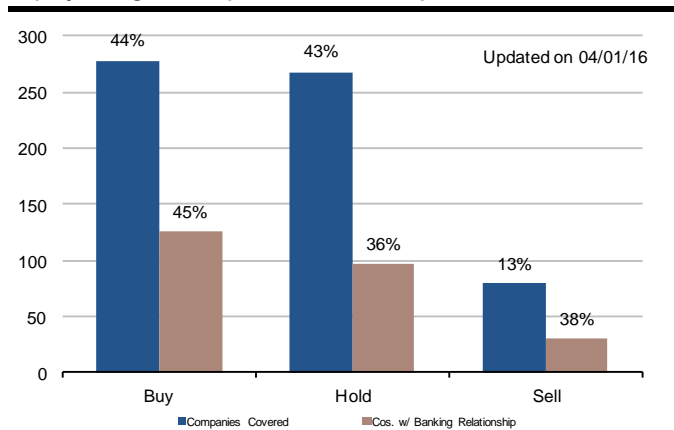
OVERWEIGHT: sector expected to outperform the relevant broad market benchmark over the next 12 months.

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

Equity rating and dispersion relationship



Source: SG Cross Asset Research/Equity

covering analyst based on the individual analyst's coverage universe and not by the SG Equity Research Strategist.

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Enagas	SG acted as joint bookrunner in Enagas' bond issue (EUR, 10yr)
Enel	SG makes a market in Enel warrants

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SG or its affiliates had an investment banking client relationship during the past 12 months with Enagas.

SG or its affiliates have received compensation for investment banking services in the past 12 months from Enagas.

SG or its affiliates managed or co-managed in the past 12 months a public offering of securities of Enagas.

SG received compensation for products and services other than investment banking services in the past 12 months from E.ON, EVN, Enagas, Enel, Norsk Hydro, SSE, Suez, Verbund.

SGAS had a non-investment banking non-securities services client relationship during the past 12 months with E.ON, Norsk Hydro.

SGAS received compensation for products and services other than investment banking services in the past 12 months from E.ON, Norsk Hydro.

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