Europe | Italy
Electric Utilities (GICS) | Utilities (Citi)

Company

28 January 2010 | 48 pages

# ENEL SpA (ENEI.MI)

Equity

## Assessing Enel's Disposal Program – Enel Green Power

- **Debt-Driven Strategy** — Enel's recent acquisitive years have reduced balance sheet headroom. Although disposals to shore up the balance sheet could take time, we believe now is a good time to examine Enel Green Power.
- **Enel Green Power Looks an Attractive Asset** — EGP has a well balanced portfolio and pipeline that is technologically and geographically diverse. High load factors and margins (driven by hydro and geothermal generation), strong cashflow and low regulatory risk provide a strong base for growth.
- **Near Term Power Prices Cause Concern** — Tariffs for renewable assets are a double-edged sword, as a large presence of these in the portfolio of assets exposes generators to political and regulatory risk, while their absence leaves generators exposed to power price fluctuations. We are concerned Italian power prices could fall near term which could delay the disposal of EGP.
- **Hydro and Geothermal Provides Strong Valuation Base** — We value Enel Green Power at an EV of €12.4bn based on a DCF valuation including the growth pipeline to 2013. The majority of the valuation is attributed to hydro, geothermal and other existing assets (>90%), which provide a sound basis for the valuation with less reliance on the growth pipeline vs peers.
- **Valuation Sensitivities** — Our EGP valuation is based on current available information and is highly sensitive to WACC assumptions. A 50bps change in WACC could move the valuation by over 7%. A variation of €1/MWh in power prices would move earnings by 2.5%, making EGP highly exposed to power prices relative to other renewable companies.

| Hold/Medium Risk | 2M |
|---|---|
| Price (28 Jan 10) | €3.90 |
| Target price | €4.30 |
| Expected share price return | 10.3% |
| Expected dividend yield | 6.9% |
| **Expected total return** | **17.3%** |
| Market Cap | €36,650M |
| | US$51,379M |

**Price Performance (RIC: ENEI.MI, BB: ENEL IM)**


**ENEL SpA (EUR)**

| Year to 31 Dec | 2007A | 2008A | 2009E | 2010E | 2011E |
|---|---|---|---|---|---|
| Sales (€M) | 43,673.0 | 61,184.0 | 51,343.3 | 58,223.1 | 57,849.9 |
| Net Income (€M) | 3,838.0 | 5,005.0 | 5,155.4 | 4,159.8 | 4,275.2 |
| Diluted EPS (€) | 0.41 | 0.53 | 0.55 | 0.44 | 0.45 |
| Diluted EPS (Old) (€) | 0.41 | 0.53 | 0.55 | 0.44 | 0.45 |
| PE (x) | 9.6 | 7.3 | 7.1 | 8.8 | 8.6 |
| EV/EBITDA (x) | 8.2 | 7.3 | 6.5 | 6.2 | 6.0 |
| DPS (€) | 0.32 | 0.32 | 0.25 | 0.27 | 0.28 |
| Net Div Yield (%) | 8.2 | 8.2 | 6.4 | 6.9 | 7.1 |


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See Appendix A-1 for Analyst Certification and important disclosures.

| Fiscal year end 31-Dec | 2007 | 2008 | 2009E | 2010E | 2011E |
|---|---|---|---|---|---|
| **Valuation Ratios** | | | | | |
| P/E adjusted (x) | 9.6 | 7.3 | 7.1 | 8.8 | 8.6 |
| EV/EBITDA adjusted (x) | 8.2 | 7.3 | 6.5 | 6.2 | 6.0 |
| P/BV (x) | 1.9 | 1.8 | 1.2 | 1.1 | 1.1 |
| Dividend yield (%) | 8.2 | 8.2 | 6.4 | 6.9 | 7.1 |
| **Per Share Data (€)** | | | | | |
| EPS adjusted | 0.41 | 0.53 | 0.55 | 0.44 | 0.45 |
| EPS reported | 0.41 | 0.54 | 0.55 | 0.45 | 0.46 |
| BVPS | 2.09 | 2.17 | 3.32 | 3.50 | 3.68 |
| DPS | 0.32 | 0.32 | 0.25 | 0.27 | 0.28 |
| **Profit & Loss (€M)** | | | | | |
| Net sales | 43,673 | 61,184 | 51,343 | 58,223 | 57,850 |
| Operating expenses | -36,683 | -51,643 | -40,849 | -47,626 | -46,910 |
| **EBIT** | **6,990** | **9,541** | **10,494** | **10,597** | **10,940** |
| Net interest expense | -914 | -3,210 | -2,451 | -2,524 | -2,629 |
| Non-operating/exceptionals | 12 | 48 | 1,013 | 53 | 54 |
| **Pre-tax profit** | **6,088** | **6,379** | **9,055** | **8,126** | **8,365** |
| Tax | -2,002 | -585 | -2,830 | -2,844 | -2,928 |
| Extraord./Min.Int./Pref.div. | -236 | -741 | -1,027 | -1,069 | -1,108 |
| **Reported net income** | **3,850** | **5,053** | **5,198** | **4,212** | **4,329** |
| Adjusted earnings | 3,838 | 5,005 | 5,155 | 4,160 | 4,275 |
| Adjusted EBITDA | 10,023 | 14,318 | 15,533 | 16,204 | 16,763 |
| **Growth Rates (%)** | | | | | |
| Sales | 13.4 | 40.1 | -16.1 | 13.4 | -0.6 |
| EBIT adjusted | 20.1 | 36.5 | 10.0 | 1.0 | 3.2 |
| EBITDA adjusted | 25.0 | 42.9 | 8.5 | 4.3 | 3.4 |
| EPS adjusted | 26.3 | 30.4 | 3.0 | -19.3 | 2.8 |
| **Cash Flow (€M)** | | | | | |
| **Operating cash flow** | **3,071** | **16,762** | **342** | **10,268** | **9,152** |
| Depreciation/amortization | 3,033 | 3,969 | 4,439 | 5,006 | 5,223 |
| Net working capital | -4,093 | 6,952 | -4,353 | 1,050 | -399 |
| **Investing cash flow** | **-4,882** | **-6,332** | **-13,136** | **-7,040** | **-6,547** |
| Capital expenditure | -4,882 | -6,332 | -8,105 | -7,040 | -6,547 |
| Acquisitions/disposals | 0 | 0 | -5,031 | 0 | 0 |
| **Financing cash flow** | **42,329** | **-4,818** | **-7,409** | **-3,228** | **-2,606** |
| Borrowings | 45,509 | -1,827 | -5,052 | -701 | -8 |
| Dividends paid | -3,180 | -2,991 | -2,357 | -2,527 | -2,597 |
| **Change in cash** | **40,518** | **5,612** | **-20,203** | **0** | **0** |
| **Balance Sheet (€M)** | | | | | |
| **Total assets** | **123,748** | **133,207** | **133,303** | **136,852** | **138,018** |
| Cash & cash equivalent | 3,648 | 8,375 | 0 | 0 | 0 |
| Accounts receivable | 11,576 | 12,378 | 11,957 | 11,964 | 11,887 |
| Net fixed assets | 55,434 | 61,524 | 66,371 | 68,405 | 69,729 |
| **Total liabilities** | **99,959** | **106,912** | **96,188** | **98,052** | **97,486** |
| Accounts payable | 9,622 | 10,600 | 7,863 | 9,400 | 9,169 |
| Total Debt | 60,169 | 58,342 | 53,290 | 52,589 | 52,581 |
| **Shareholders' funds** | **23,789** | **26,295** | **37,114** | **38,799** | **40,531** |
| **Profitability/Solvency Ratios (%)** | | | | | |
| EBITDA margin adjusted | 23.0 | 23.4 | 30.3 | 27.8 | 29.0 |
| ROE adjusted | 20.2 | 25.0 | 20.0 | 13.0 | 12.7 |
| ROIC adjusted | 7.8 | 10.2 | 8.5 | 8.1 | 8.3 |
| Net debt to equity | 237.6 | 190.0 | 143.6 | 135.5 | 129.7 |
| Total debt to capital | 71.7 | 68.9 | 58.9 | 57.5 | 56.5 |

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# Contents

# 1. Not the usual renewable company

Last year ENEL stated that the sale of its renewable business would have contributed proceeds of c€3.5bn to the reduction of its debt to €50bn by the end of 2009.

The planned disposal of up to 49% of ENEL Green Power (EGP) is part of a larger disposal plan of €10bn that includes gas distribution assets and transmission of electricity in Italy, both sold already, and transmission of electricity in Spain which, like EGP, has been delayed to 2010.

As it stands, ENEL's net debt is at 3.2x EBITDA 2010E falling to 2.8x in 2013E, assuming EGP and Spanish transmission assets are not sold. ENEL stated it wants to sell a minority stake in EGP although it is not clear whether the sale/IPO will be done via a sale of existing shares or a capital increase. That said, a disposal would bring in fresh new money, reducing the more than €53bn net debt that we estimate for FY09E - an important step in strengthening ENEL's balance sheet that the market should welcome.

In this report we take a closer look at EGP, its operations, business model and growth opportunity. There is no change in our forecasts for ENEL but we want to shed some more light on an asset that is important in the context of ENEL's debt and is also important in the context of the sub-sector of renewable companies in Europe. All in all we think EGP is a different renewable company from those that we have seen so far and that are listed in Europe (or that are not listed yet as in the case of the renewable divisions of EON and RWE).

As to the timing of the sale/IPO, given current market conditions and the fact that we think Italian power prices could fall soon, we would not be surprised if EGP sale/IPO was to be delayed until the end of 1H10 or maybe early in 2H10, therefore we expect no newsflow in the short term. This may be seen as disappointing by ENEL shareholders hoping for a faster process.

## 1.1. What we like

We think EGP has a well balanced technology portfolio supplemented by good geographical diversification. Allied to this, the company is experienced in developing and operating all major renewable technologies and should see strong earnings growth from a pipeline that is diverse, both by technology and geography when compared with other peers in Europe.

- **High load factors giving high operating margins** — With hydro and geothermal technologies providing the bulk of output in Italy, the company is able to achieve high average load factors across its portfolio of assets and generate high operating margins.

- **Low exposure to incentives and low regulatory risk** — Less than 30% of EGP's output is subject to regulatory incentives and therefore there is less risk from regulation change in its markets.

- **Strong targeted Free Cash Flow vs peers** — EGP is targeting €5bn of operating cashflow 2009-13, according to its business plan, compared to budgeted capex of c. €3.7bn. This implies positive free cash flow in this period compared to peers which have a c. 50% OCF/Capex ratio on average.

- **Not a project but a real company** – EGP stands out as renewable company with a multi-decade experience in managing hydro and geothermal assets set to grow into wind. Most of its valuation rests on the existing assets that already generate significant EBITDA.

## 1.2. What we dislike now but could like later

Tariffs for renewable assets are a double-edged sword, as a large presence of these in the portfolio of assets exposes generators to political and regulatory risk. Their absence leaves generators exposed to fluctuations of power prices.

EGP's capacity is mainly baseload and therefore price-taking in the Italian market. Depending on when EGP will be sold and the commodity outlook at that time, ENEL may fetch different prices for its assets.

At present we are worried Italian power prices could fall. We believe this could further delay the disposal of EGP, which would not be positive news for ENEL. However, if EGP is sold after power prices have fallen, ie towards the end of this year, investors may appreciate its leverage to power prices and what is perceived as 'bad' now could become 'desirable' later.

**A Word of caution**

Our assessment of Enel Green Power and the valuation we ascribe to the business is based on the information made available by the company during its presentation in April 2009. As Enel moves closer to a partial divestment of Enel Green Power, we would expect more information to become available which could alter our assumptions and ultimately, our valuation of the business. In addition, our valuation of the business may be subject to change in the event that the scope of consolidation changes.

## 1.3. Background

Enel Green Power is positioning to take advantage of the strong growth expected in renewable energy generation over the next 2 decades.

The Global Wind Energy Council has forecast a c. 160% growth in the global installed renewable capacity base by 2020 and should therefore lead to approximately 3TW of capacity at this time. The highest growth is expected to come from the wind, solar and biomass segments (CAGR 08-20 of 17%, 37% and 20% respectively).

The Italian government alone targets 12 GW of wind capacity, 9.5GW of solar and 8.5GW of other hydro and geothermal by 2020. This would amount to a target of 30GW of renewable generation by 2020 compared with 4.6GW installed capacity in 2008.

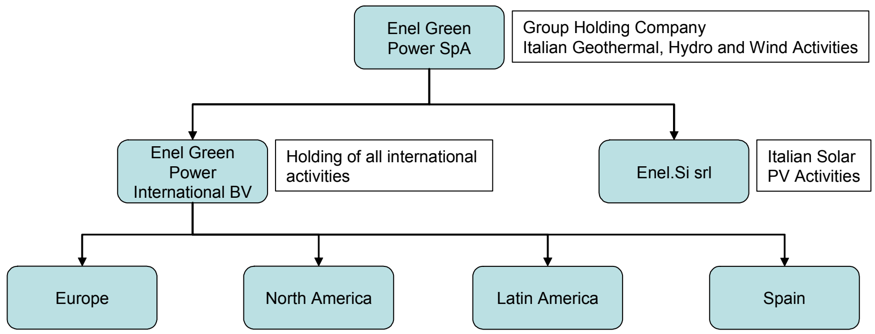
Enel Green Power is the division of the Enel Group established to develop and manage renewable energy operations in Italy and throughout the world. The company is responsible for all of the Enel Group's activities in the wind, solar, geothermal and run-of-the-river hydroelectric plants.

With nearly 4.5GW of installed capacity, Enel Green Power is the leading Italian organization with internationally integrated operations in the renewable energy industry. The company looks to:

- Develop Enel's presence in renewables industries in international markets
- Establish leadership in Italy in the solar, hydroelectric and geothermal markets and to become a leader in the wind power segment;
- Gain scale internationally to compete in global markets
- Focus on technological diversity for renewable energy.

Enel.si is a company of the Enel Group that specializes in developing and producing plants for renewable energy production and solutions for energy efficiency.

**Figure 1. Enel Green Power — Divisional Structure**




Source: Company Reports, Citi Investment Research and Analysis

Enel Green Power is run by Francesco Starace who is the Managing Director. Mr Starace is a former nuclear engineer and has previously worked for General Electric, ABB and Alstom and has worked in many regions including the US, Europe and the Middle East. With Enel, he was previously a manager in the generation division before moving to be managing director of the Market division. With a varied background both geographically and by discipline, Mr Starace would appear well positioned to take the company forward and maximize growth.

# 2. What we like

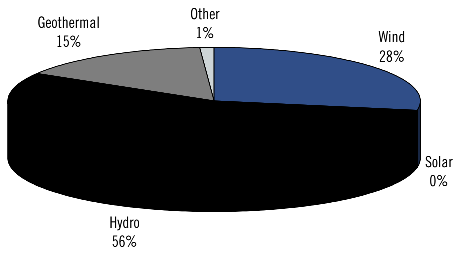
There are a number of factors that we like in EGP, amongst which are a diversified mix of geographies and technologies, and its substantial presence in hydro and geothermal that are virtually absent in all other listed renewable companies. This also means higher load factors than its peers, a slow but solid EBITDA growth, and attractive operating cashflows that help finance the near €4bn of capex 2009-13.

## 2.1. Diversified mix of geographies and technologies

EGP has renewable generation activities throughout Europe, North America and Latin America, with several generation technologies in use across the portfolio.

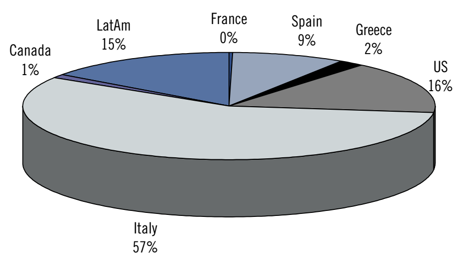
Figures 2 and 3 show EGP's split of renewable generation capacity by technology and geographical exposure, highlighting the concentration in the Italian market and the use of hydro technology.

**Figure 2. 2008 Capacity by Technology**




Source: Company Reports, Citi Investment Research and Analysis

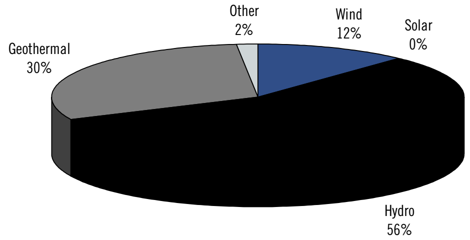
**Figure 3. 2008 Capacity by Geography**




Source: Company Reports, Citi Investment Research and Analysis

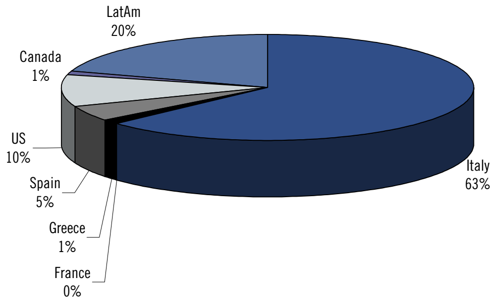
In Italy, the use of the traded green certificate system provides a significant incentive to renewable players looking for exposure to new renewable technologies, effectively more than doubling the pool price available to qualifying technologies. Green certificates in Italy have traded on average at €102-103/MWh in 2008 and 2009 (including VAT) which is one of the highest incentives for new wind/hydro renewable electricity in Europe. This indicates that building new renewable capacity in Italy continues to be a sound strategy and positive for the company's positioning going forward.

**Figure 4. 2008 Output by Technology**




Source: Company Reports, Citi Investment Research and Analysis

**Figure 5. 2008 Output by Geography**

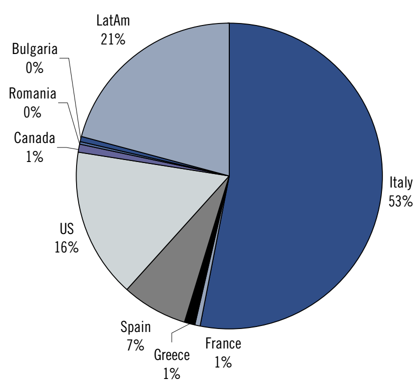



Source: Company Reports, Citi Investment Research and Analysis

For EGP, the majority of hydro and geothermal exposure (80-90%) in Italy precedes the introduction of the green certificate system and is therefore required to only take the pool price for the electricity produced. The large hydro exposure in Italy (Figures 4 and 5) is therefore not as well rewarded as new investment but is high margin and provides good cashflow for growth. EGP is repowering some hydro plants with more efficient turbines which will qualify for green certificates and provide higher returns in future. This forms part of the reason for the focus on Italy in EGP's growth strategy and our forecast capex profile for EGP to 2013E as detailed in Figure 7.

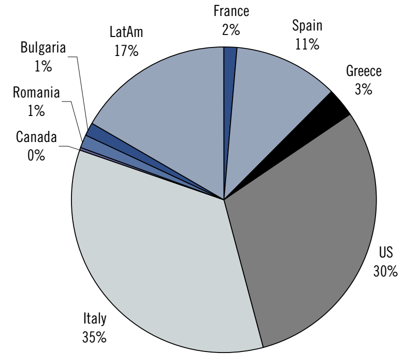
Figure 6 shows our forecasts for generation output by Geography in 2013E indicating the reduced exposure to Italy and increase in exposure to Latin and North America. However, we would expect the green certificate price to have declined significantly by 2013 due to accelerated renewable construction and therefore reduced Italian exposure should be less of an issue.

**Figure 6. Enel Green Power— Generation Output by Geographical Exposure 2013E**




Source: Company Reports, Citi Investment Research and Analysis

**Figure 7. Enel Green Power — Cumulative Capex by Geography 2009-13E**



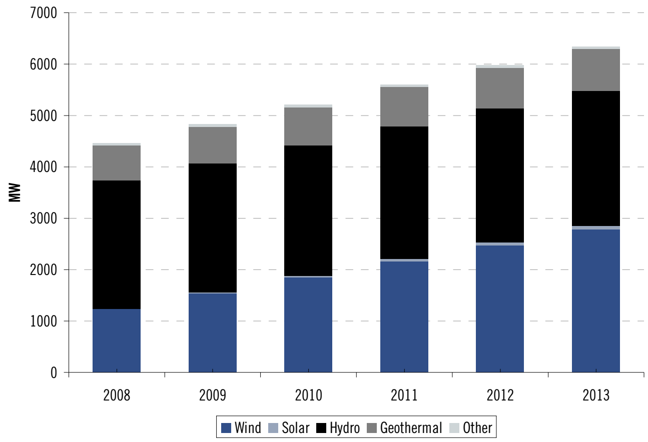

Source: Company Reports, Citi Investment Research and Analysis

However, as green certificates are traded, there is not an obvious long term floor price (the GME exchange provides a short term floor price) and therefore, investment in renewables in Italy remains partially exposed to risks on investment return.

Another issue to consider is the extent to which each regulatory regime is susceptible to changes in commodities and power prices. In Italy and Spain, a large part of the remuneration is from the “pool price + premium” mechanism and therefore has high exposure and leverage to the actual underlying power price. Some installations in Spain take a feed-in tariff which limits upside but the “pool + premium” system is also capped by regulation, also limiting upside. In the case of Iberdrola Renovables, it has hedged its Iberian output out to June 2011 which also caps its leverage to increasing power prices. Natural power price leverage is in part balanced by the US and some of Latin America where there are PPAs available to ensure fixed prices on long term contracts. Recent trends in utilities have been to lock in prices, either through forward contracting or PPAs and we see further exposure to fixed prices in the US as a positive for EGP given recent power price volatility and uncertainty in Europe. However, we acknowledge that this would dilute the gearing to a power price recovery as economies throughout the world recover.

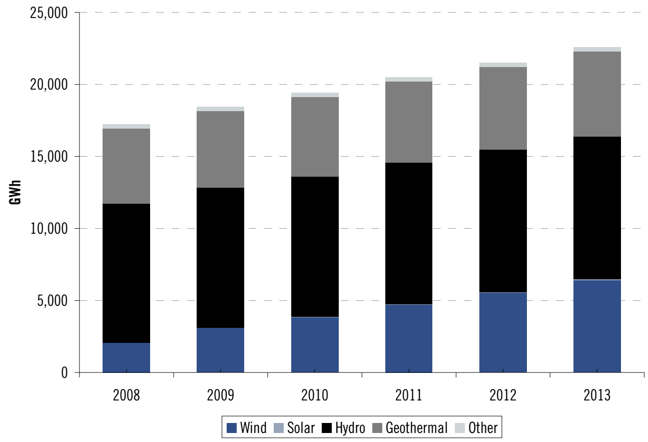
A focus on growth in the US looks a sensible strategy for EGP given the renewed commitment to renewable regulation in the US (ITC or PTC), the renewable portfolio standards by state and the prospect of fixed PPAs for 15-20 years. We envisage competition increasing markedly in the US due to this regulation but we believe there is plenty of scope for multiple European players (IBR, EDPR, E.ON, EEN) to participate competitively in the US market. The US is committed to generating 20% of electricity from wind energy by 2030, which according to the American Wind Energy Association, will see 16GW of annual installations by 2018 and continuing at that rate until 2030.

**Figure 8. Technology Capacity 2009-13E**




Source: Company Reports, Citi Investment Research and Analysis

**Figure 9. Technology Output Forecasts 2009-13E**



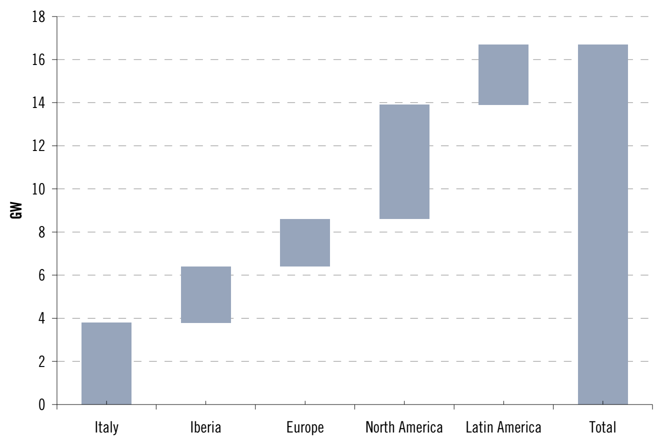

Source: Company Reports, Citi Investment Research and Analysis

Figures 8 and 9 highlight the growth in wind capacity and output we forecast for EGP across all regions. The potential for high wind load factors and ease of planning permission in the US makes this market particularly attractive and provides EGP with a strong growth strategy despite the likely competition from IBR and EDPR among others.

Wind power is also the cheapest of the renewable sources of energy to construct on a €/KW basis, with current estimates from industry players of c. €1200-1300/KW, while offering potential solid returns through the production tax credit and long term PPAs in the US (8.7% post-tax project IRR) or Italy with the green certificates (10.6% post-tax project IRR).

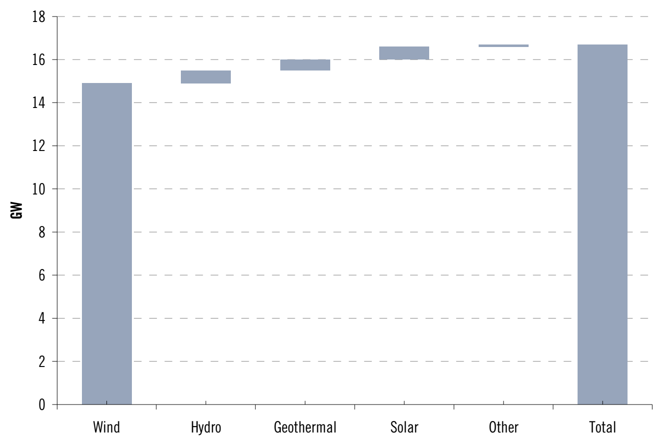
EGP's focus on wind generation does not discriminate between onshore and offshore technologies but we would expect onshore to be the main source of EGP's growth in wind energy to 2013. Offshore wind is a far riskier investment proposition with no guarantee that returns offer risk/reward to match onshore wind development, where there is greater construction and O&M experience in the industry.

**Figure 10. Enel — Generation Pipline by Geographical Exposure**




Source: Company Reports

**Figure 11. Enel — Generation Pipeline by Technology**




Source: Company Reports

EGP's development pipeline for renewables is shown in Figures 10 and 11. These charts suggest that EGP's future exposure should be in the less-risky areas of wind development (where regulation is accommodating and well developed) and geographically in Italy and the US where regulation overall is set to adequately incentivise new renewable investment.

We highlight in a previous chapter where EGP is exposed and the strengths of its technological and geographical choices.

Below in figure 12, we show our forecasts for EGP's capacity in various locations to 2015E, highlighting the growth in the US, Latin America and Italy.

**Figure 12. Enel Green Power — Capacity by Country, 2008-15E (MW)**

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|---|
| France | 12 | 22 | 32 | 42 | 52 | 62 | 62 | 62 |
| Spain | 398 | 448 | 498 | 548 | 598 | 648 | 648 | 648 |
| Greece | 91 | 111 | 131 | 155 | 175 | 185 | 185 | 185 |
| US | 700 | 809 | 918 | 1027 | 1136 | 1245 | 1245 | 1245 |
| Italy | 2547 | 2629 | 2727 | 2837 | 2930 | 3025 | 3025 | 3025 |
| Canada | 48 | 48 | 48 | 48 | 48 | 48 | 48 | 48 |
| Romania | 0 | 10 | 20 | 30 | 40 | 50 | 50 | 50 |
| Bulgaria | 0 | 10 | 20 | 30 | 40 | 50 | 50 | 50 |
| LatAm | 667 | 739 | 811 | 883 | 955 | 1027 | 1027 | 1027 |
| **Total** | **4464** | **4827** | **5206** | **5601** | **5975** | **6341** | **6341** | **6341** |

Source: Company Reports and CIRA Estimates

EGP's pipeline of 16.7GW consists of 6GW of solid pipeline either under construction or with over 50% confidence of construction while there remains 10.7GW of additional opportunities which could be developed in to more solid potential projects.

## 2.2. High load factor

EGP targets 6.3GW of installed capacity in 2013 from the pipeline, in line with our forecasts and 22.7TWh of output. This is an increase of 42% in capacity and 31% in output compared to 2008 implying the load factor of the business will decline to an average of 42% from 46%. This reflects the shift to wind energy in EGP's portfolio from the higher load factor hydro and geothermal although this is still higher than load factors at IBR and EDPR. This is due to the wind-focused portfolio of assets at the Iberian companies, while EGP's run-of-river hydro and geothermal generation attract c. 40% and 90% load factors respectively in Italy.

**Figure 13. Enel Green Power — Citi Operational Forecasts 2013E**

| | Capacity (MW) | Output (TWh) |
|---|---|---|
| Wind | 2777 | 6.4 |
| Solar | 75 | 0.1 |
| Hydro | 2629 | 9.9 |
| Geothermal | 813 | 5.9 |

Source: Company Reports and CIRA Estimates

In figure 13, we show our forecasts for EGP's capacity and output targets by technology. Given the relatively small pipeline and the company's experience, we believe the targets are achievable and therefore we feel comfortable with our forecasts.

## 2.3. Lower but solid EBITDA growth

We expect EBITDA to hit €1.6bn as ENEL should achieve 6.3GW of capacity by 2013. ENEL should be able to achieve this due to its historically strong position in the Italian market, amongst other things. EGP has set similar targets in its business plan and we believe these are reliable.

The assumption that EGP will hit its targets in 2013 informs our forecasts in this period and we show our estimates in figure 38 below. EGP, based on its operational targets in 2013, is guiding to revenues of €2,855m in 2013 and EBITDA of €1,602m, +54% and +35% increases respectively compared to 2008. The company also stated in its presentation to capital markets that it would achieve a cumulative EBITDA in the period 2009-2013 of €6.7bn vs our forecast of €7.1bn.

**Figure 14. Enel Green Power — EBITDA and EBIT Forecasts, 2007-15E (€m)**

| | 2007 | 2008 | 2009E | 2010E | 2011E | 2012E | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|---|
| **Revenue** | **1536** | **1852** | **1882** | **2010** | **2214** | **2495** | **2831** | **2870** | **2935** |
| Operating Costs | (547) | (664) | (598) | (704) | (832) | (984) | (1189) | (1222) | (1265) |
| **EBITDA** | **989** | **1188** | **1284** | **1306** | **1382** | **1511** | **1641** | **1648** | **1670** |
| EBITDA Margin % | 64.4% | 64.1% | 68.2% | 65.0% | 62.4% | 60.6% | 58.0% | 57.4% | 56.9% |
| D&A | (381) | (416) | (432) | (448) | (464) | (480) | (495) | (500) | (504) |
| **EBIT** | **608** | **772** | **852** | **858** | **918** | **1031** | **1146** | **1148** | **1166** |
| EBIT Margin % | 39.6% | 41.7% | 45.3% | 42.7% | 41.5% | 41.3% | 40.5% | 40.0% | 39.7% |

Source: Company Reports and CIRA Estimates

EGP has also provided a breakdown of how it expects its EBITDA target in 2013 to be split by technology, which we detail below in figure 39.

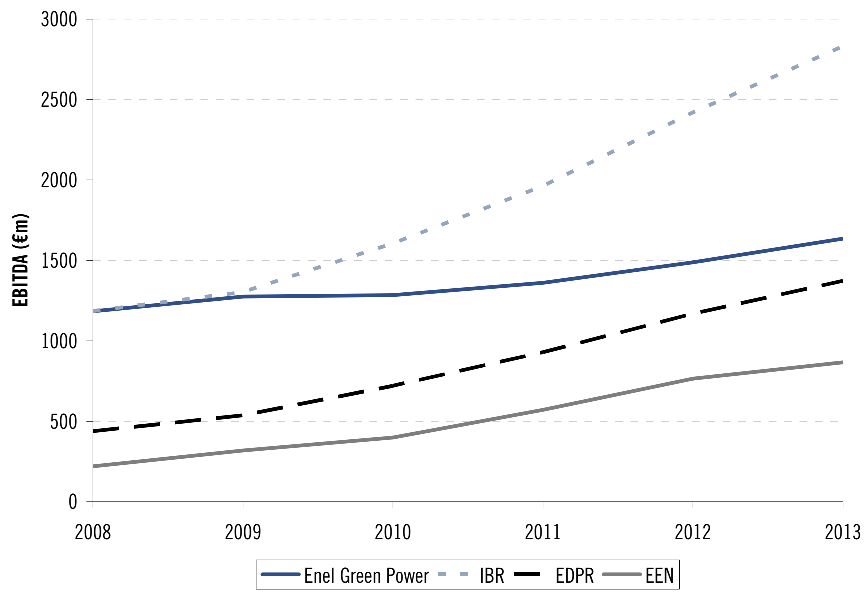
**Figure 15. Enel Green Power – EBITDA Targets 2008-13 (€m)**

| | 2008 | 2013 |
|---|---|---|
| Wind | 201 | 560 |
| Solar | 0 | 16 |
| Hydro | 498 | 560 |
| Geothermal | 463 | 448 |
| Other | 23 | 16 |
| Total | 1188 | 1602 |

Source: Company Reports

Below we show our EBITDA forecasts for Enel Green Power vs those of its peers in Europe, IBR, EDPR and EDF Energies Nouvelles. The chart highlights EGP's lower growth profile compared to peers but EGP has the benefit of a solid base of hydro and geothermal generation output which is well established and forms a significant part of the valuation of the company. In this respect, investors already have visibility on earnings and returns, unlike peers where there is still an element of uncertainty in the pipeline of projects being pursued that drive growth.

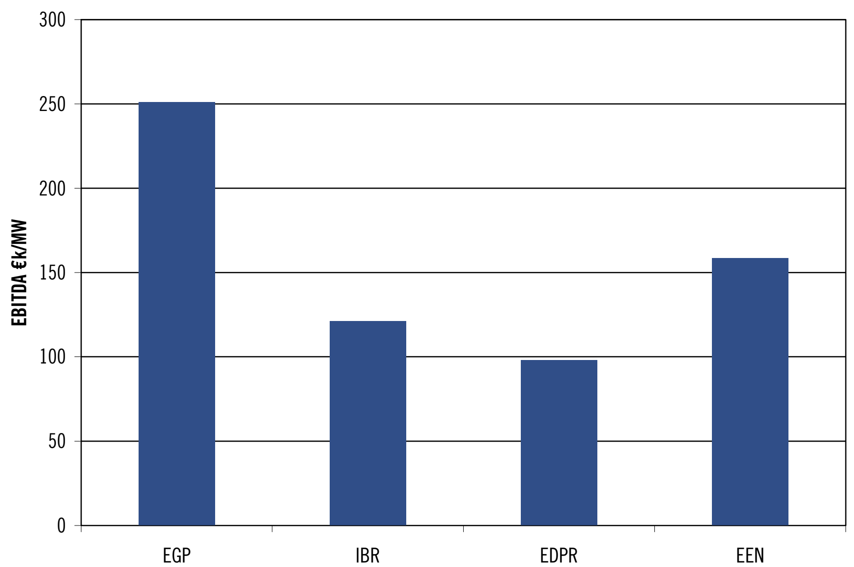
**Figure 16. Enel Green Power EBITDA vs Peers 2008-13E (€m)**




Source: Company Reports, Citi Investment Research and Analysis

Figure 19 shows a comparison of EBITDA/MW for the European renewable companies. We show here how EGP's high hydro and geothermal load factors provide significantly higher EBITDA per generation unit compared with peers where wind generation capacity dominates the portfolios. This high stable margin provides a solid base and cashflow for EGP to pursue other growth projects without risking balance sheet strength.

**Figure 17. European Renewables – EBITDA (€k) Per Installed MW of Capacity, 2010**




Source: Company Reports, Citi Investment Research and Analysis

## 2.4. High Capex but attractive cash flows

To achieve the capacity targets set out in figure 37, we envisage that EGP will have to spend in the region of €3.9bn 2009-2013E based on our assumption of construction cost trends over this period.

In figure 40 below, we detail capex, both growth and maintenance, by geography and would highlight in particular the spend in Italy (c. 50% growth capex), the US (c. 80% growth) and Latin America (c. 75% growth).

**Figure 18. Enel Green Power — Capex 2008-15E (€m)**

| | 2009E | 2010E | 2011E | 2012E | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|
| France | 12 | 12 | 12 | 12 | 12 | 1 | 1 |
| Spain | 91 | 89 | 87 | 85 | 83 | 16 | 15 |
| Greece | 26 | 26 | 34 | 25 | 14 | 4 | 4 |
| US | 241 | 236 | 234 | 232 | 230 | 48 | 47 |
| Italy | 261 | 288 | 300 | 258 | 256 | 126 | 126 |
| Canada | 2 | 2 | 2 | 2 | 2 | 2 | 2 |
| Romania | 12 | 12 | 12 | 12 | 11 | 1 | 1 |
| Bulgaria | 12 | 12 | 12 | 12 | 11 | 1 | 1 |
| LatAm | 133 | 131 | 131 | 132 | 132 | 39 | 39 |
| **Total** | **790** | **808** | **825** | **769** | **752** | **238** | **236** |

Source: Company Reports and CIRA Estimates

In our capex assumptions, we have assumed the following regarding construction costs:

- **Onshore Wind** — €1,167/KW in 2009 falling to €1,033/KW in 2013
- **Solar** — €4,075/KW in 2009 falling to €3,175/KW in 2013.
- **Hydro** — €2,200/KW in 2009 remaining constant to 2013.
- **Geothermal** — €3,958/KW in 2009 falling to €3,792/KW in 2013.

In its investor day presentation, Enel stated that EGP was targeting operating cash flow of c. €5bn for the period 2009-13. This compares to a projected capex plan of €3.7bn over the same 5 years and implies free cash flow generation of €1.3bn in this period.

Of the strategic plan, 60% of the capex will be spent on wind generation, 14% on hydro and 18% on geothermal, highlighting the company's strategy of focusing on US and Italian wind investment. This growth capex plan is significantly less aggressive than the large European peers such as Iberdrola Renovables and EDP Renovaveis which target €13bn and €9bn respectively in capex to 2015.

However, where we believe EGP has an advantage is in the funding of its capex from operating cash flow, unlike peers. In the table below, we show the ratio of EBITDA to capex for the main renewable players in Europe on our forecasts.

**Figure 19. European Renewables – EBITDA/Capex Ratios 2009-13E**

| **EBITDA** | **2009** | **2010** | **2011** | **2012** | **2013** |
|---|---|---|---|---|---|
| EGP | 1,284 | 1,306 | 1,382 | 1,511 | 1,641 |
| IBR | 1,304 | 1,606 | 1,963 | 2,421 | 2,832 |
| EDPR | 537 | 720 | 929 | 1,168 | 1,373 |
| EEN | 318 | 399 | 570 | 765 | 867 |
| | | | | | |
| **Capex** | | | | | |
| EGP | 790 | 808 | 825 | 769 | 752 |
| IBR | 1,868 | 2,342 | 2,741 | 2,562 | 2,990 |
| EDPR | 1,571 | 1,604 | 1,625 | 1,619 | 2,096 |
| EEN | 1,178 | 1,180 | 1,047 | 932 | 641 |
| | | | | | |
| **OCF/Capex** | | | | | |
| EGP | 1.63 | 1.62 | 1.68 | 1.96 | 2.18 |
| IBR | 0.70 | 0.69 | 0.72 | 0.94 | 0.95 |
| EDPR | 0.34 | 0.45 | 0.57 | 0.72 | 0.66 |
| EEN | 0.27 | 0.34 | 0.54 | 0.82 | 1.35 |

Source: Company Reports, Citi Investment Research and Analysis

Note: EDF Energies Nouvelles' current business plan ends in 2012 and therefore capex drops off in 2013 as a result.

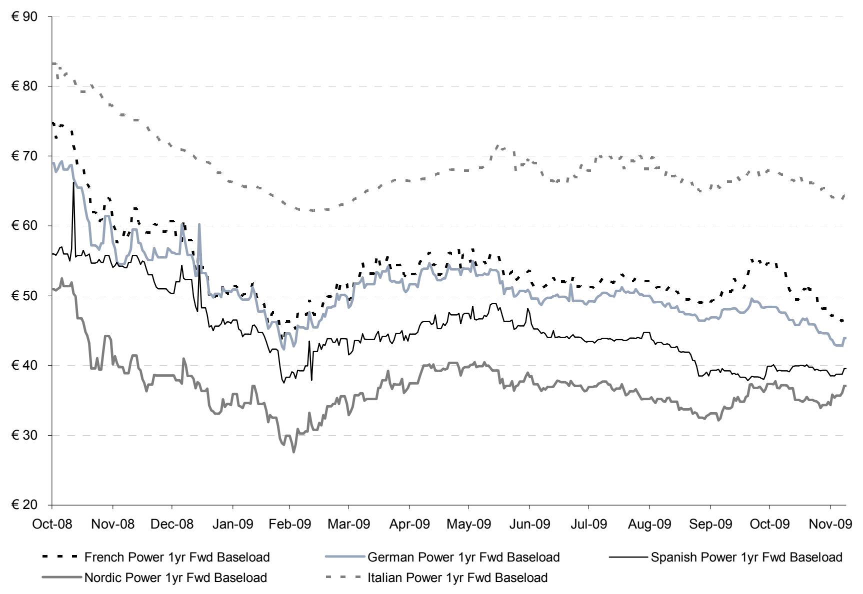
This highlights how strong the business model is at EGP with the hydro and geothermal generation providing significant cashflow to fund expansionary capex.

IBR and EDPR have leverage ratios of 4.4x and 6.5x Net Debt/EBITDA respectively and are potentially adding leverage as they progress through the current growth plans. Although the leverage at EGP has yet to be decided by Enel and EGP management, we would note that Enel currently has leverage of c. 3.2x EBITDA and therefore would not anticipate vastly higher leverage than this. However, in the event that net debt is higher than anticipated, this would add further leverage to the overall business model and may provide promising prospects for equity investors if recovering economies drive a rally in commodity and power markets. As we have suggested, we believe there is near-term downside to Italian power prices but could then see a recovery later in 2010.

# 3. What we dislike now but could like later

In 2009 we witnessed a generalized movement downwards of commodities, and power prices in Europe were no exception, as shown in figure 20.

**Figure 20. 1YR forward power prices in Europe (€/MWh)**




Source: Bloomberg, Citi Investment Research and Analysis

Fuel burnt to produce electricity is the main component of power prices around Europe (with the exception perhaps of the Nordic market where most of the power is produced with renewables and nuclear) and as this fell, so did power prices.

Generally speaking, we can split Europe in two areas: North/Central and South. In Southern Europe (Iberia and Italy) the electricity market is dominated by gas-fed generating units while in Central/North (Germany, the Netherlands, Eastern European countries) coal dominates[1]. So a first important point is to understand what will happen to coal and gas prices in 2010 to properly assess opportunities and risks in these two blocks and how the marginal and non-marginal plants my interact in Italy. Our conclusion is that we feel more relaxed about the North/Central areas but less so in the Southern Europe, Italy in particular (see: Where do we go from here, Alberto Ponti, for a full analysis of German power prices).

Another force that has been driving down power prices was the reserve margin. As new capacity was developed over the past five years in most European countries, demand destruction caused by recession in 2009 has substantially increased spare capacity in the system. As existing generators compete for a smaller market (in volumes) competitiveness increases and spreads reduce as a consequence.

[1] When we say "coal dominates" in fact we mean that German power prices are often used as a benchmark in most of these countries, but it is in Germany where coal is the price-setting fuel. France is dominated by nuclear but we leave it out from this discussion since wholesale prices are generally regulated as they are in Greece where power is produced via a mix of lignite, gas and fuel oil.

All European countries appear oversupplied at the moment, but the decline in spreads is not even across the different markets. Notably Spain has perhaps suffered the most, Germany has seen some strong reduction already while Italy appears immune and it is here where we see the greater risk.

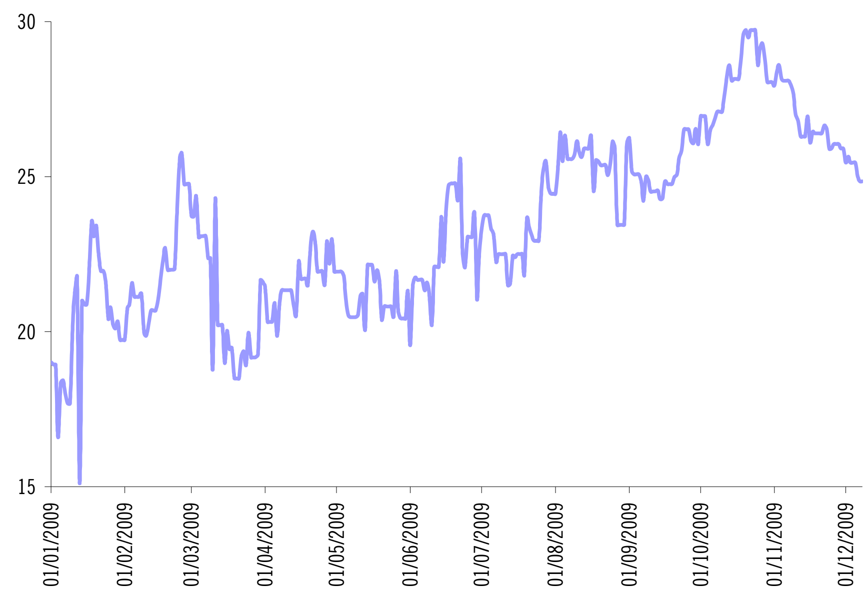
In 2009 many utilities in Europe cut back on Capex but the evidence so far of new power stations being cancelled is patchy. In Italy no new power stations have been cancelled, to our knowledge, over the past 12-18 months whilst in Spain a wealth of new wind units keep coming on line. In Germany, Denmark and the Nordic countries some cancellations have emerged.

### Italian Power Prices At Risk

Italian 1 year forward baseload power prices have already increased by €2/MWh and then declined by €2.5/MWh in 2010 highlighting the volatility that remains in the Italian market and where there could remain near term risk to EGP.

Southern European power markets, namely Iberia and Italy, are dominated by gas, which is the price setting fuel for most hours in each market. Recession hit both markets and so did the fall in demand of electricity and gas, however, with very different consequences.

**Figure 21. 1YR forward prices – spread Italy vs Spain (€/MWh)**




Source: Company Reports, Citi Investment Research and Analysis

Figure 21 shows the spread between Italian and Spanish forward power prices. Italy has increased its premium over Spain since the start of 2009 by more than €5/MWh.

**Spain**

In Spain power prices literally collapsed in 2009 due to a combination of factors:

- Demand of electricity – fell 4.8% thus increasing the reserve margin in the system, the situation was exacerbated by a good rainy season and programmed shut downs;
- Renewable capacity – a number of new units came on line thus increasing the reserve margin even further, up to 30% according to our estimates;
- Demand of gas – fell 11%. Spain is an 'energetic island', excess gas cannot be exported to France given the limited interconnection (Larrau, 2Bcm) and therefore has to be burnt in the power stations, hence the fall in power prices.

Impact of new renewable is likely to continue for the next 3-4 years as we see additional c3GW p.a. (already approved by the Government) coming on line (mainly wind) while demand of electricity and gas is pegged to GDP growth.

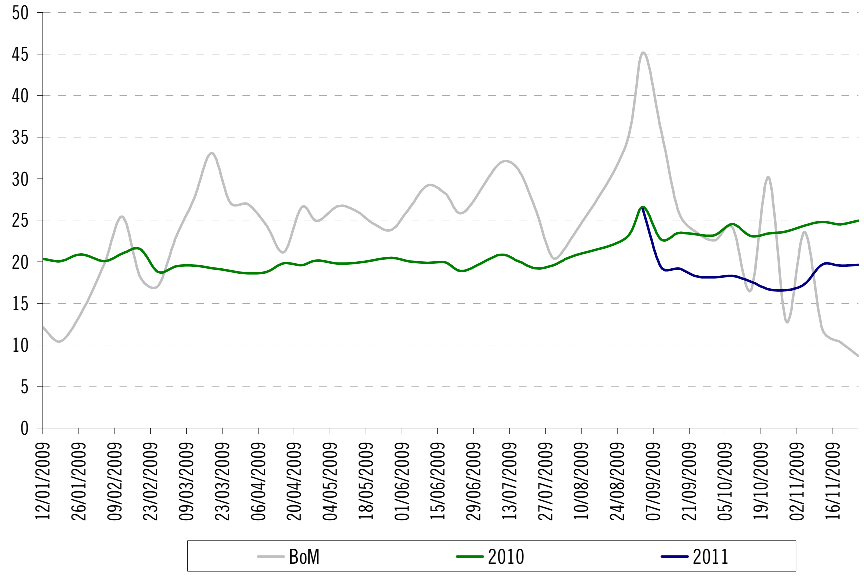
We think power prices will keep struggling in Spain through 2010 but the upshot is that in Spain we have seen already the damage that recession and oversupply in gas can cause, whilst for Italy we are more concerned.

**Italy**

Power prices in Italy fell in 2009, but the spread to other European markets has increased (see Figure 20). The gas market also looks different from the rest of Europe: as we noted earlier, gas prices in Italy remain at a premium to the rest of Europe while recently spot prices have pulled back to the same level of prices in long term contracts, quite differently to Germany where the spot is half the contracted price.

This helps to explain why power prices have remained higher, so far, then in the rest of Europe, but the Italian market also appears to be very healthy on the spreads front, as shown in Figure 22, since Italy displays the highest clean spark spreads in the whole of Europe. And while the 2011 spread records a decrease of c€5/MWh vs 2010, it still trades at c€20/MWh.

**Figure 22. Italy – clean spark spread (€/MWh)**




Source: Albasoluzioni, Citi Investment Research and Analysis

Latest observations for 2010 prices and spreads are not very meaningful given how thin the forward market is at the moment, yet the 2010 delivery traded at €20/MWh for the most part of 2009, ie when the market was more liquid.

**Figure 23. Italy – clean dark spreads (€/MWh)**

| | 2010 E | 2011 E |
|---|---|---|
| Jan-09 | 29.9 | n.a. |
| Jun-09 | 31.6 | n.a. |
| Dec-09 | 30.0 | 28.6 |

Source: Albasoluzioni, Citi Investment Research and Analysis

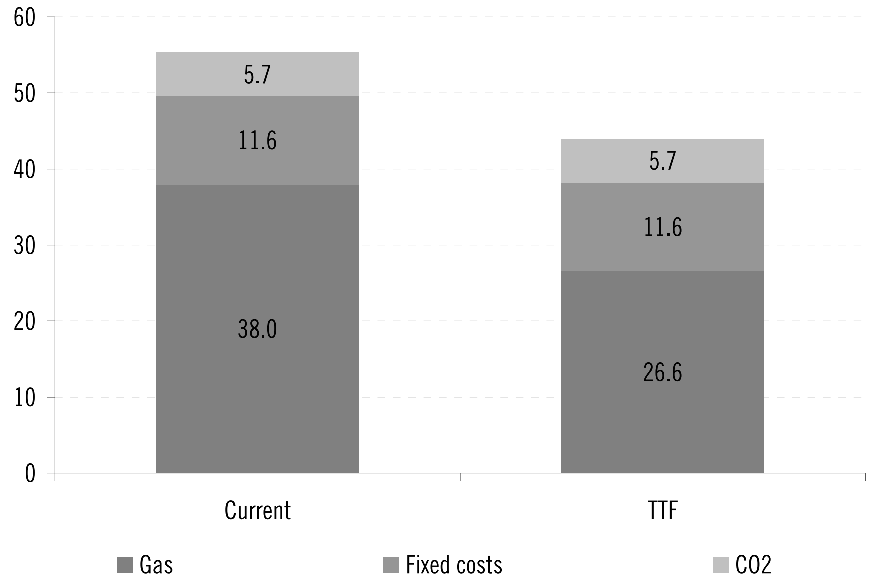
Since coal in Italy as an infra-marginal technology, it gains higher margins than gas, as shown in Figure 23 where clean dark spreads are reported above €28/MWh, ie 4x bigger than in Germany right now.

Using current forward 2010 gas prices, in Figure 24 we calculate the new entrant cost for the Italian market which assumes a clean spark spread of €17/MWh that is lower than forward spreads in Figure 24. The total new entrant cost is at €55/MWh vs current 2011 forward prices of €67/MWh.

With all this in mind we see downside risk to Italian power prices. It is difficult to explain, in our view, how the high spreads can be sustained in the future given rising reserve margins and the fall in demand of electricity, which has taken the Italian market back to 2003 levels. Therefore spreads could reduce going forwards.

Also, it is increasingly difficult to justify Italian gas prices being at a premium to the rest of Europe. In Figure 24 we recalculate the new entrant cost assuming Italian gas prices converge to TTF levels. In this case the total cost would be just €44/MWh, a good €23/MWh discount to current 2011 electricity price.

**Figure 24. New entrant price under different gas assumptions (€/MWh)**




Source: Company Reports, Citi Investment Research and Analysis

All in all our analysis leads us to believe that there is downside to power prices in Italy and that spreads should fall too. Falling power prices would obviously have negative consequences for dark spreads too.

# 4. Valuation and sensitivities

We value EGP using DCF valuations for existing assets by country of operation and DCF valuations on a per MW basis for pipeline assets. We therefore value the company on the basis of its entire 6.3GW forecast portfolio by 2013.

Using a blended WACC of 7% for the group, we arrive at an enterprise valuation of c. €12.4bn. This compares to a WACC of 6.5% for IBR and 6.8% for EDPR. We show our absolute EV valuation in the table below by country and split by existing assets vs pipeline assets.

Our valuation of wind assets in Spain corresponds to €1,284kw, a slight discount to our equivalent valuations at IBR and EDPR (c. €1,466/kw) but this is understandable given the slightly higher cost of capital we use.

**Figure 25. Enel Green Power — Enterprise Valuation by Region (€m)**

| | MW | EV | €/kW |
|---|---|---|---|
| **Existing** | | | |
| Italy | 2,629.2 | 7,207.4 | 2,741.3 |
| France | 11.6 | 17.7 | 1,521.9 |
| Greece | 91.3 | 145.7 | 1,596.0 |
| Spain | 398.3 | 511.4 | 1,283.9 |
| US | 700.2 | 1,043.7 | 1,490.6 |
| Canada | 48.4 | 33.9 | 699.7 |
| Romania | | | |
| Bulgaria | | | |
| LatAm | 666.9 | 2,072.6 | 3,107.6 |
| **Total** | **4,545.9** | **11,032.3** | **2,426.9** |
| | | | |
| **Pipeline 2009-2013** | | | |
| Italy | 396.0 | 184.9 | |
| France | 50.0 | 2.2 | |
| Greece | 94.0 | 73.1 | |
| Spain | 250.0 | 89.6 | |
| US | 545.0 | 190.7 | |
| Canada | | | |
| Romania | 50.0 | 22.1 | |
| Bulgaria | 50.0 | 5.0 | |
| LatAm | 360.0 | 398.8 | |
| **Total** | **1,795.0** | **966.5** | |
| | | | |
| Wind - Land Portfolio (€200/kw) | | 370.0 | |
| | | | |
| **Total** | | **12,368.8** | |

Source: Company Reports, Citi Investment Research and Analysis

Our assessment of Enel Green Power and the valuation we ascribe to the business is based on the information made available by the company during its presentation in April 2009. As Enel moves closer to a partial divestment of Enel Green Power, we would expect more information to become available which could alter our assumptions and ultimately, our valuation of the business. In addition, our valuation of the business may be subject to change in the event that the scope of consolidation changes.

Over 90% of our valuation comes from the existing assets in the EGP generation portfolio. This compares very favourably with European peers where 75-80% of the EV comes from existing assets.

In our view, this breakdown of valuation provides a lower risk profile for EGP's valuation as less value is attributed to the pipeline where construction and other development risks remain.

**Figure 26. Enel Green Power – Pipeline Valuation Beyond 2013**

| | MW | EV | €/kW |
|---|---|---|---|
| Existing | 4,545.9 | 11,032.3 | 2,426.9 |
| Pipeline 2009-2013 | 1,795.0 | 966.5 | 538.5 |
| Wind - Land Portfolio (€200/kw) | | 370.0 | |
| **Total** | | **12,368.8** | |
| | | | |
| **Pipeline beyond 2013** | | | |
| Italy | | 1,024.6 | |
| France | | 18.1 | |
| Greece | | 730.3 | |
| Spain | | 435.8 | |
| US | | 1,098.3 | |
| Canada | | | |
| Romania | | 82.7 | |
| Bulgaria | | 18.8 | |
| LatAm | | 1,457.0 | |
| **Total** | | **4,865.6** | |
| | | | |
| **EGP Total Including Full Pipeline** | | **17,234.4** | |

Source: Company Reports, Citi Investment Research and Analysis

In the figure above, we show our valuation of the pipeline beyond 2013. Although we ascribe no value to the long term pipeline in our overall valuation, this table shows a potential c. €5bn option for new projects beyond 2013. Attaching only a 20% probability to the commissioning of the whole pipeline after 2013 could still add nearly €1bn to our valuation. In arriving at this pipeline value, we have assumed that the remaining pipeline of projects not already accounted for between 2009-2013 are commissioned on a pro-rata basis for the next 10 years to 2023.

**Figure 27. European Renewables – EV/EBITDA 2009-12E**

| | 2009E | 2010E | 2011E | 2012E |
|---|---|---|---|---|
| EGP | 9.6 | 9.5 | 8.9 | 8.2 |
| IBR | 14.8 | 12.9 | 11.3 | 9.7 |
| EDPR | 17.1 | 14.1 | 12.1 | 10.2 |
| EEN | 17.1 | 16.6 | 12.9 | 10.5 |

Source: Company Reports, Citi Investment Research and Analysis

Comparing EGP's valuation to that of European peers above, we see that our valuation implies a significant discount on an EV/EBITDA basis. EGP is on c. 9.5x 2010e EV/EBITDA compared with IBR at 12.9x and EDPR at 14.1x. Given the high penetration of hydro and geothermal output, we believe that investors could deem such a discount too large in relation to the stability of the main business in Italy. As such, a 10-15% discount to IBR (our preferred pick in the renewables space) may be more appropriate in the eyes of the market, in which case, our EV valuation for EGP would range between €14.3-15.1bn. Below we show the sensitivities to peer valuation discounts.

**Figure 28. EGP – Discount to Peer Valuations – EV/EBITDA Valuation (€m) 2010**

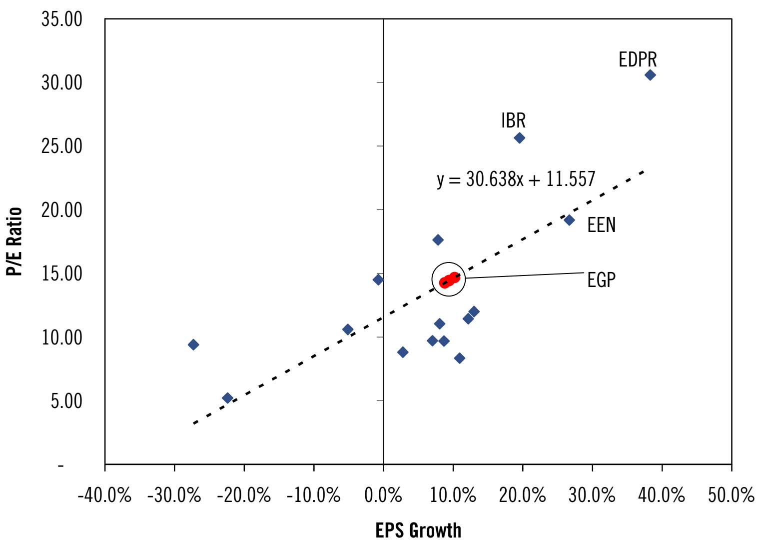
| | EV/EBITDA | 5% | 10% | 15% | 20% | 25% | 30% |
|---|---|---|---|---|---|---|---|
| IBR | 12.9 | 15,976.0 | 15,135.1 | 14,294.3 | 13,453.4 | 12,612.6 | 11,771.8 |
| EDPR | 14.1 | 17,552.0 | 16,628.2 | 15,704.4 | 14,780.6 | 13,856.9 | 12,933.1 |
| EEN | 16.6 | 20,590.8 | 19,507.1 | 18,423.4 | 17,339.6 | 16,255.9 | 15,172.2 |

Source: Company Reports, Citi Investment Research and Analysis

A discount is also warranted due to the exposure to commodities (and therefore less defensive) but in a recovering economy, with commodity prices potentially rallying, earnings growth could be significantly ahead of our modeLling.

On an EV/MW basis, our valuation implies €2,427/kw for the existing assets of in Enel Green Power's portfolio which appears reasonable when considering the high penetration of hydro and geothermal output and high margins attainable.

**Figure 29. P/E Valuations vs EPS Growth – European Utilities Gencos**




Source: Company Reports, Citi Investment Research and Analysis

Above we show the P/E valuations of the generator and renewable companies in the sector, the average regression line and highlight where EGP would sit based on our anticipation of EPS growth in 2011 (c. 9-11% depending on assumed leverage of 2-4x net debt/EBITDA). Relative to other renewable operators, EGP sits in a reasonable position, on a lower valuation due to lower growth. However, it is worth noting how close is to other generators in the sector despite the fact that it has higher leverage to power prices than most and has more renewable exposure.

## 4.1 Separating EGP from other renewable generators

When assessing Enel Green Power in the current market, we have taken into account the views of our equity strategists and would draw attention to several points which could play in favour of Enel Green Power in comparison to peers.

- Although economic recovery is likely to be slow and painful in developed markets in Europe, global recovery could drive global commodity prices higher. Therefore Enel Green Power can benefit from its exposure to power prices, especially in Italy. We would also note that, in contrast, IBR has fully hedged its available output in Spain and therefore would be unable to take advantage of an upswing in power prices.
- Our equity strategists favour emerging markets for growth as GDP recovery is likely to be stronger in these markets over the next few years. Enel Green Power, compared to EDPR and IBR, has strong exposure to Latam and is building presence in Eastern European markets over the period of the strategic plan.
- Another distinguishing factor is the potential for a strong balance sheet and cashflow at EGP. Our strategists highlight the need for a strong balance sheet as economies start the next cycle and EGP could be in this position, or at least moving towards it. This is in contrast to IBR and EDPR where we estimate capex will continue to outstrip OCF for a number of years and leverage for both will stay above 4x and 6x EBITDA respectively.

## 4.2. Earnings Sensitivity

The widely accepted view in the renewables market in recent years is that renewable generation and associated tariff structures provide defensive earnings capacity and visibility due to the nature of fixed feed-in tariffs and other regulatory support mechanisms. In contrast, in the past 12 months, the market has learnt that conventional thermal generating utilities are not as defensive as previously thought, since demand destruction has led to drops in power prices and spreads, impacting profitability. The must-run nature of renewables, and therefore a low position in the merit order, suggested to many in the market that renewables would remain defensive as marginal (thermal) generation plants would suffer from demand destruction.

However, our analysis of EGP's earnings and operational model highlights high sensitivity of EBITDA to small variations in a number of factors including pool power prices and currency.

### Power prices

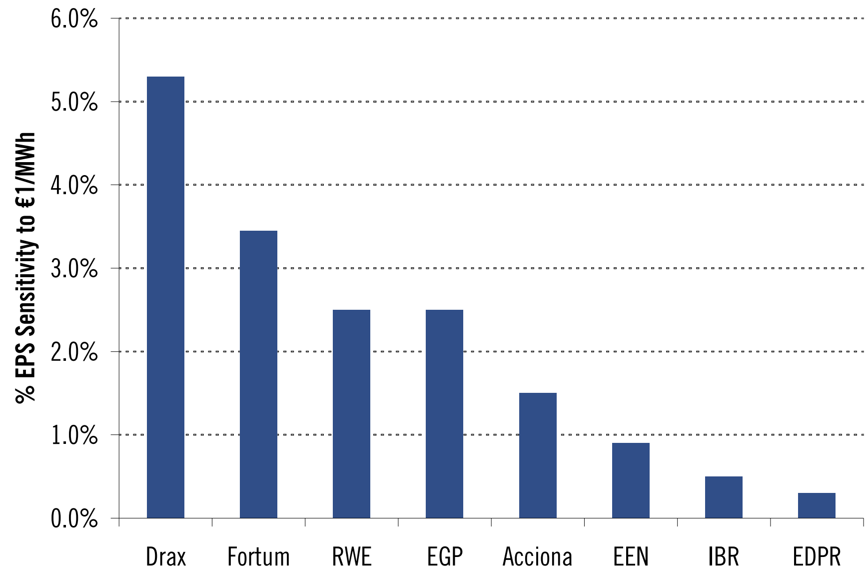
**Figure 30. Enel Green Power — Earnings Sensitivities to €1/MWh Change in Power Price**

| | 2010E | 2011E | 2012E |
|---|---|---|---|
| EBITDA | 0.9% | 1.4% | 1.3% |
| EBIT | 1.4% | 2.1% | 1.9% |

Source: Citi Investment Research and Analysi s

In figure 41, we show EGP's earnings sensitivities to a €1/MWh change in power prices across all markets in 2010-12E.

**Figure 31. EPS Sensitivity to €1/MWh Change in Power Prices, 2011E**




Source: Company Reports, Citi Investment Research and Analysis
Note: This assumes a 3x Net Debt/EBITDA leverage ratio for EGP

Above we show how EGP compares to the other generators and renewable operators in the sector on EPS sensitivity to power prices.

A 1.4% move in EBITDA from €1/MWh in power price in 2011E for EGP is comparable to the vertically integrated utilities with no forward hedging of output. EGP is actually more geared to pool prices than many other utilities (although not more pure generators such as Drax or Fortum) and we believe more geared than the market has realized.

**Figure 32. EPS Sensitivities - €1/MWh at various leverage levels**

| Net Debt | 2010 | 2011 | 2012 |
|---|---|---|---|
| 1x EBITDA | 1.5% | 2.3% | 2.1% |
| 2x EBITDA | 1.7% | 2.5% | 2.3% |
| 3x EBITDA | 1.8% | 2.7% | 2.5% |
| 4x EBITDA | 2.0% | 2.9% | 2.7% |

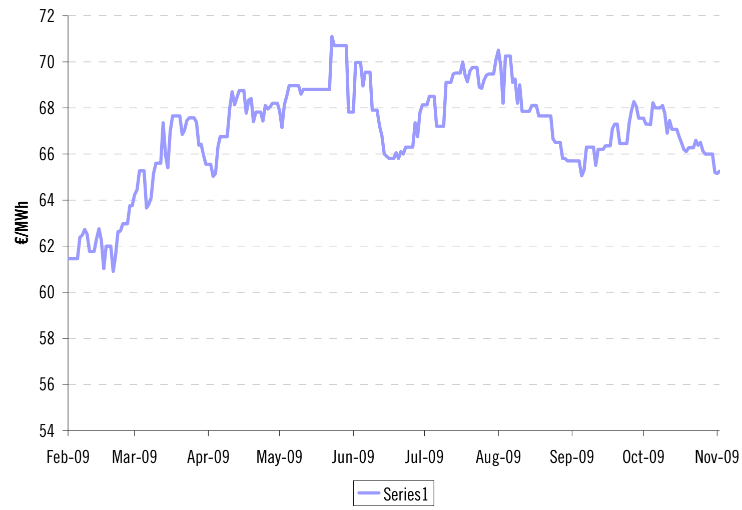
Source: Company Reports, Citi Investment Research and Analysis

In figure 32, we show EPS sensitivities to €1/MWh assuming varying levels of leverage. In this analysis we have assumed debt interest costs of 5% and a 35% tax rate. The analysis indicates the leverage in the business model that can then be increased through financial leverage. Currently, we do not have any indication of the structure of the balance sheet but clearly there is a trade-off between debt levels at EGP and the earnings risk (or reward) that equity investors would be willing to take on.

In figure 33, we show the trend in the Italian pool price in 2009 for 1 year forward baseload prices. The chart shows 1 year forward baseload prices at c. €61.5/MWh in the early part of 2009 but these rallied to close to €71/MWh in June before falling back to €65-66/MWh. In 4Q 2008, the 1yr forward baseload price in Italy averaged €81/MWh before slumping to €61.5/MWh in February 2009.

On this basis, EGP's EPS would have been cut sharply in 4Q08/1Q09 just on the back of weaker power prices and assuming no hedging. This would then be followed by a significant increase in earnings in mid 2009. This potential volatility in earnings is not indicative of the view the market has of renewable generators but is an important aspect to understand about the earnings risk given low operating costs and tariff exposure to the pool prices.

**Figure 33. Italian Pool Price — 1 Year Forward Baseload (€/MWh)**




Source: Bloomberg

In the current market, Enel Green Power's exposure and sensitivity to pool power prices is likely to divide opinion, as the market appears undecided on the near and medium term outlook for power prices across Europe. In a rising power price environment, EGP looks attractive. However, economic recovery and power price inflation looks potentially drawn out over coming years, while the steepness of the contango in the forward power curve suggests prices could see further downside.

## Wacc and load factor

**Figure 34. EGP Valuation Sensitivities**

| | Base case Valuation | 50bps Existing Assets WACC Reduction | €1/MWh Delta in Portfoliio Power Prices | 1000bps delta in Italian hydro load factors |
|---|---|---|---|---|
| Existing Assets | 11,032.3 | 11,910.1 | 11,172.7 | 10,021.1 |
| Pipeline Assets | 966.5 | 966.5 | 998.9 | 966.5 |
| Other | 370.0 | 370.0 | 370.0 | 370.0 |
| **Total Valuation** | **12,368.8** | **13,246.6** | **12,541.6** | **11,357.6** |
| % Change | | 7.1% | 1.3% | -8.2% |

Source: Company Reports, Citi Investment Research and Analysis

In the table above, we show the sensitivity of our valuation to changes in WACC assumptions, long-term power prices and hydro load factors. The table highlights the sensitivity of the model to WACC assumptions for the bulk of the business (ie. the existing assets) but also the fact that reduced load factors of hydro output could have a significant impact on the valuation. However, although there is some risk of changing rainfall patterns, we would note that EGP are upgrading a number of hydro plants with more efficient turbines, which could offset possible less precipitation to mitigate some of this risk to load factors.

### Currencies

Figures 35 shows the sensitivities of EBITDA to changes in economic assumptions on currency and inflation.

**Figure 35. Enel Green Power — Earnings Sensitivities to 10% Unilateral Euro Strengthening**

| | 2010E | 2011E | 2012E |
|---|---|---|---|
| EBITDA | -0.9% | -1.1% | -1.2% |
| EBIT | -1.5% | -1.8% | -1.8% |

Source: Company Reports, Citi Investment Research and Analysis

Figure 35 highlights the impact of unilateral Euro strength on EBITDA, indicating that increasing exposure to the US through 2012 would negatively impact earnings, as would higher exposure in Latin America.

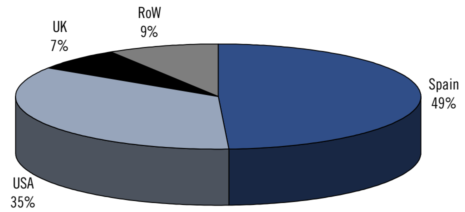
# Peer Analysis

# 5. Peer Analysis

## 5.1 Iberdrola Renovables

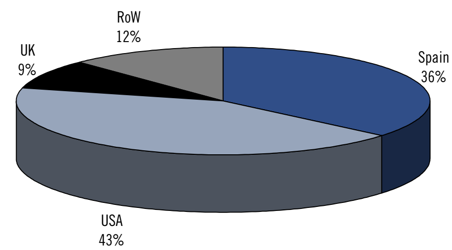
Iberdrola Renovables (IBR) is the largest wind operator globally with over 10GW of installed capacity and a further 13GW targeted by 2015. IBR is a strong competitor to EGP in the US and Spain. The company is primarily focused on Wind energy development, transferring its knowledge base and experience in the wind sector between locations to take advantage of favourable regulatory regimes.

**Figure 36. IBR — Capacity by Geography 2008**




Source: Company Reports, Citi Investment Research and Analysis

**Figure 37. IBR — Capacity by Geography 2012**




Source: Company Reports, Citi Investment Research and Analysis

IBR is primarily located in Spain and the US having been a key player in the build out of wind capacity in Spain in recent years. The company then took advantage of the huge opportunities in the US with the RPS requirements and either the investment tax credits or production tax credits combined with long term PPAs.

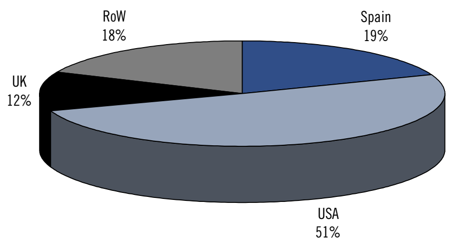
As shown in Figures 36 and 37, IBR will focus more on the US and other locations outside of Spain in coming years as favourable regulatory conditions should persist in other markets as governments incentivise renewable development to hit official targets.

By 2012, on our forecasts, the US will account for 40% of IBR's EBITDA exposure and the UK and Rest of World together another 23%. To reach this, IBR's pipeline at the end of 2008 is heavily skewed to the US with over half of all projects likely to be developed in the US.

That said, the pipeline for IBR consists of nearly 44GW of capacity, 22.1GW of which is in the US. This represents significant execution and investment risk for the company to be able to shift the focus of its business away from Spain and towards more incentivised markets in the future. In contrast, EGP has a more balanced and smaller pipeline which accounts for less of the overall valuation and therefore we would anticipate more visibility on valuation compared with IBR. However, mitigating this, we would note IBR's strong track record on installations and development.

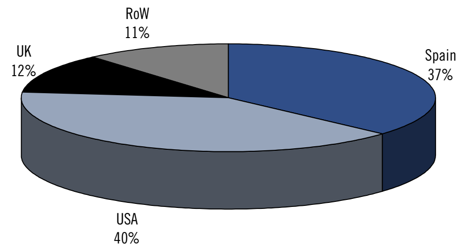
Also in contrast to IBR, EGP is also exposed to several technologies (with related experience) which provides some diversification of risk while IBR is solely exposed to wind energy currently with some presence forecast in solar thermal technologies in future years.

**Figure 38. IBR — Pipeline by Geography 2008**




Source: Company Reports, Citi Investment Research and Analysis

**Figure 39. IBR — EBITDA by Geography 2012E**



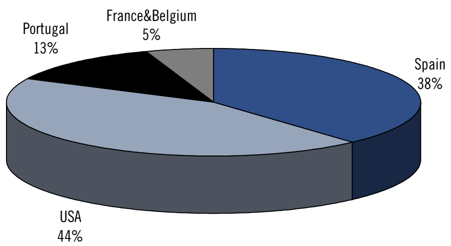

Source: Company Reports, Citi Investment Research and Analysis

As a pure renewable player, IBR is our preferred play compared to EDPR, EEN and Acciona. IBR has good exposure to PPAs and therefore earnings and cash flow visibility along with geographical diversification, size and good links to turbine suppliers. However, we believe that EGP should also be considered a leading renewable player given its diversified capacity portfolio, good geographical exposure and experience in its chosen sectors.

## 5.2 EDP Renovaveis

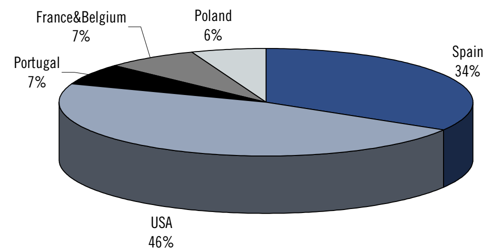
EDP Renovaveis (EDPR) is the 4th largest wind operator globally, with over 5.5GW of installed capacity and a further 10GW targeted by 2015. As with IBR, the company is primarily focused on Wind energy development, using the knowledge base and experience from the Iberian market to gain market shares in other markets with promising tariff structures.

**Figure 40. EDPR — Capacity by Geography 2008**




Source: Company Reports, Citi Investment Research and Analysis

**Figure 41. EDPR — Capacity by Geography 2012**




Source: Company Reports, Citi Investment Research and Analysis

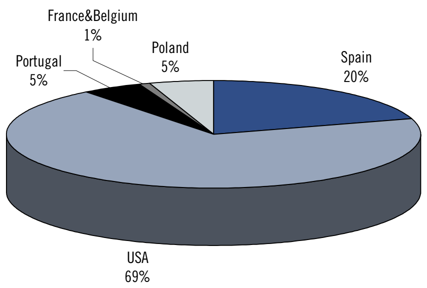
In a similar way to IBR, EDPR is primarily located in Spain and the US having participated in the ramp up of renewable capacity in both markets.

By 2012, on our forecasts, the US will account for 46% of EDPR's capacity exposure with Spain accounting for the lion's share of the rest.

EDPR's pipeline (Figure 42) shows that two thirds of the pipeline is US focused, a factor which should play in EDPR's favour given the high wind load factors in the US compared to other geographies added to EDPR's rigorous site selection and ability to drive load factors even higher then competitors.

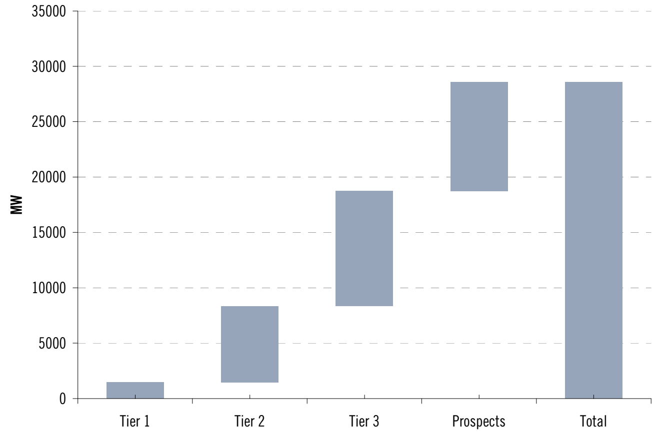
In figure 19 we show EDPR's project pipeline as presented at EDP's 9M 2009 Results. EDPR classifies its pipeline in three tiers according to progress on planning, contracts and other applications. In our forecasts, we assume nearly 10GW of extra capacity from the pipeline by 2015. This accounts for c. 23% of our valuation for EDPR where execution risk, and therefore uncertainty, is high.

**Figure 42. EDPR — Gross Pipeline by Geography 2009**




Source: Company Reports, Citi Investment Research and Analysis

**Figure 43. EDPR — Pipeline by Classification at 9M 2009 Results**



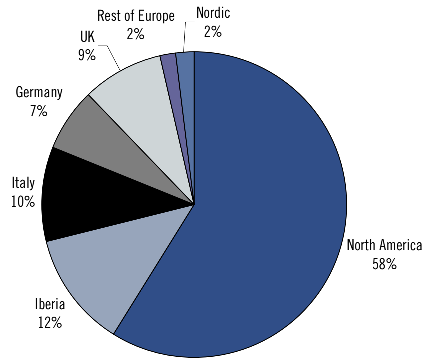

Source: Company Reports, Citi Investment Research and Analysis

## 5.3 E.ON

E.ON's renewable businesses are held under the E.ON Climate and Renewables division (EC&R). E.ON has a significant hydro capacity held within the Central Europe division which is not included in EC&R.

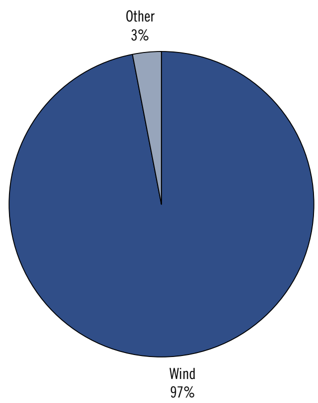
EC&R is characterized by high exposure to the US (c. 58%) and is almost solely concentrated on wind energy development across the US and some European markets.

**Figure 44. E.ON — Generation Capacity by Geography, 2009**




Source: Company Reports

**Figure 45. E.ON — Generation Capacity by Technology, 2009**



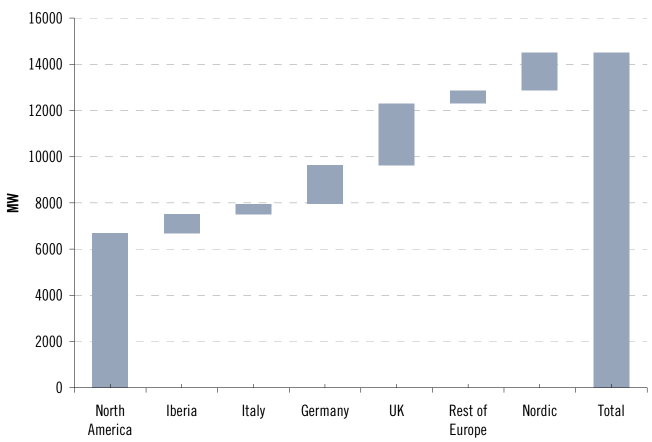

Source: Company Reports

EC&R has 2.8GW of renewable capacity of which 1.7GW is in the US where favourable regulatory conditions exist through the Production Tax Credit, recent stimulus measures and a political focus on cutting emissions.

A recent press release from the company highlighted a 7 year O&M deal with General Electric to cover 529 turbines amounting to nearly 800MW of capacity. This is designed to ensure turbine availability for E.ON's build out program and maximize turbine operation to achieve the highest load factors possible. This also underlines E.ON's commitment to the US and wind energy development in that market while reducing supplier risk.

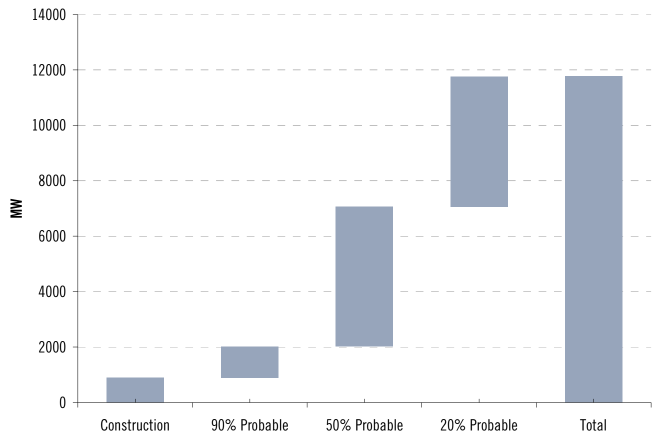
The lack of diversity in renewable technologies could be seen as a weakness in this business model although the focus in the pipeline on the US (where PPA agreements are common) and a mix of other territories provides some diversity while the remuneration structures in Spain, Italy and the UK provide some exposure to power price recovery.

**Figure 46. E.ON — Generation Pipeline by Geographical Exposure**




Source: Company Reports

**Figure 47. E.ON — Generation Pipeline by Probability of Success**




Source: Company Reports

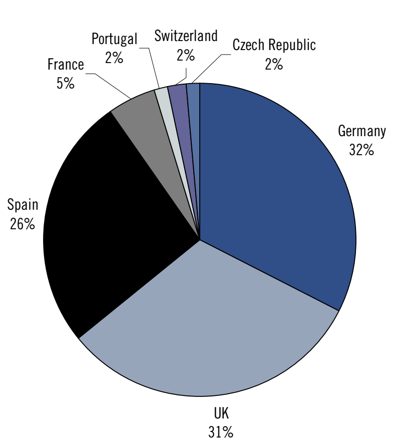
Part of E.ON's pipeline in the UK involves participation in the offshore London Array project in the Thames Estuary. Despite the project including Dong Energy, an experienced offshore developer, we would be cautious on offshore wind projects such as this given the risks involved both in construction and operation. O&M costs and construction costs will be higher for offshore wind requiring higher remuneration which the UK regulation accommodates through the ROC system and the allocation of 2 ROCs (Renewable Obligation Certificates) currently for each MWh of offshore wind generation. However, despite this we remain sceptical on the returns available for offshore wind development and would prefer to see risk in renewables mitigated through development of onshore wind in favourable markets such as the US where load factors are high.

## 5.4 RWE

RWE's renewable development is held within RWE Innogy and comprises 1.3GW, including large hydro in Germany and is reasonably well balanced between Germany, UK and Spain.

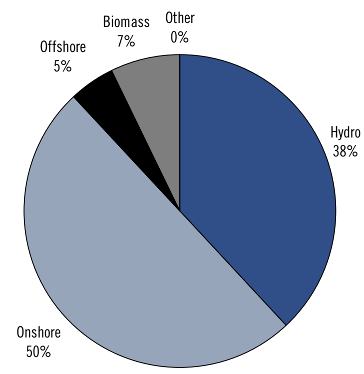
Of the wind capacity in RWE Innogy, there is 654MW of onshore wind with the majority split between UK and Spain while there is also 60MW of offshore wind capacity.

**Figure 48. RWE — Generation Capacity by Geography, 2009**



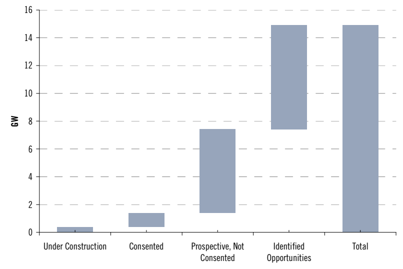

Source: Company Reports

**Figure 49. RWE — Generation Capacity by Technology, 2009**




Source: Company Reports

**Figure 50. RWE — Renewable Generation Capacity Pipeline**




Source: Company Reports, Citi Investment Research and Analysis

The focus on wind capacity is sensible for RWE, although the markets in which it is exposed such as Spain and the UK provide some risk in that the tariff structures are based a pool price with a premium applied. Any weakness in the pool prices will impact margins directly although this will be positive a strong power price environment. In the UK there are some PPAs established for some of the output which partly mitigates this commodity risk.

In Germany where the majority of capacity is hydro, there is still exposure to the power price, although at potentially lower returns given there is no premium attached to the pool price for hydro generation.

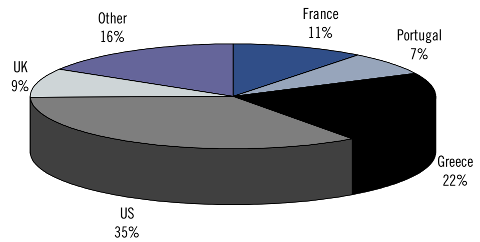
In comparison with peers, RWE is a smaller renewable generator albeit with a reasonable mix of geographies and technologies. However, the chosen exposures (non US and offshore wind in some cases) do not, in our view, provide the desired portfolio going forward.

The pipeline shown in figure 26 shows less than 2GW under construction or consented, indicating that RWE may continue to lack scale in this business, while the targeted projects are a mix of onshore and offshore wind with risks to returns and costs are higher in the latter.

## 5.5 EDF Energies Nouvelles

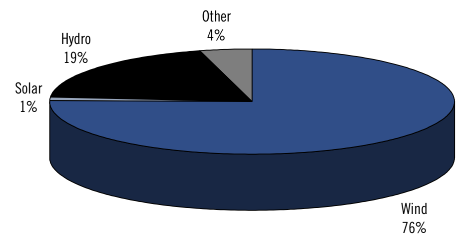
EDF Energies Nouvelles (EEN) is a smaller renewable player with a slightly different business model compared with the other larger renewable generators. EEN has an installed renewable capacity base of under 2GW spread across similar geographies and technologies as other companies analysed above. However, EEN differs from other players in that it has a dedicated O&M division which provides O&M services to owners of other wind farms and a development division which plans, develops and constructs wind farms before selling them on to third party operators as turnkey projects.

**Figure 51. EEN — Capacity by Geography 2008**




Source: Company Reports

**Figure 52. EEN — Capacity by Technology 2008**




Source: Company Reports

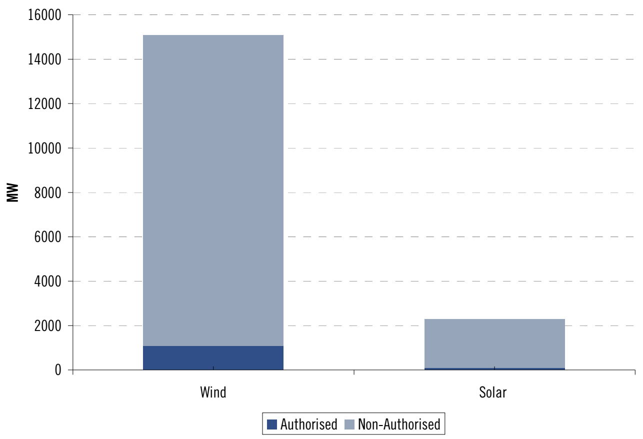
The key aspect of EEN's business model is that it can be financed very cheaply as it has arguably the strongest parent company in the sector — ultimately the French government — from a financing perspective.

With this access to cheap finance, the company has a low WACC and is therefore able to pursue projects which other renewable players may avoid, leaving the potential to gain market share in its chosen markets.

EEN has strong presence in the US through its generation activities but also through both construction and O&M operations. Outside the US, the portfolio is well balanced geographically taking advantage of favourable tariffs in Greece as well as building small exposure in other markets throughout Europe.

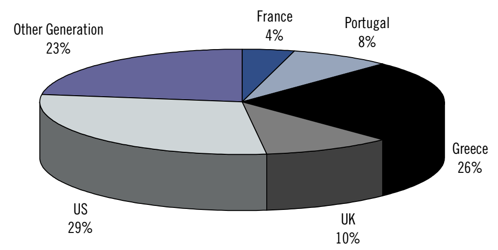
EEN, unlike many of the larger renewable players, is also focusing on Solar PV construction and generation and has recently signed a supply partnership with First Solar to establish a factory in France to secure cheap PV supply for several years. Given the cost of solar research, development and construction and its relative infancy, we believe it is sensible for the larger players to avoid and leave this market to EEN for the time being, especially given the point on financing noted above.

**Figure 53. EEN — Pipeline by Technology and Status 1H 2009**




Source: Company Reports, Citi Investment Research and Analysis

**Figure 54. EEN — EBITDA by Geography 2008**




Source: Company Reports, Citi Investment Research and Analysis

EEN has a large pipeline relative to its installed capacity base and has targeted 4000MW of installed capacity by 2012 from the current c. 1.8GW. This doubling of capacity by 2012 implies a significant portion of the valuation of the company is dependent on strong execution of the pipeline. Although the majority of the pipeline is focused on wind energy and should therefore be slightly less risky, the presence of solar development and some offshore wind projects indicates to us that there is still considerable execution risk, a factor less evidenced in EGP's current business and pipeline.

**Companies Mentioned**

| Company | RIC | | Rating | TP Currency | Target Price | SP Currency | Share Price |
|---|---|---|---|---|---|---|---|
| Acciona | ANA.MC | 1 | H | EUR | 117.00 | EUR | 89.40 |
| Drax Grp | DRX.L | 3 | H | GBP | 3.95 | GBP | 4.11 |
| EDF Energies Nou | EEN.PA | 2 | H | EUR | 37.00 | EUR | 36.07 |
| EDP Renovaveis | EDPR.LS | 2 | M | EUR | 7.70 | EUR | 6.34 |
| Fortum | FUM1V.HE | 2 | H | EUR | 16.00 | EUR | 18.26 |
| Iberdrola Renovables | IBR.MC | 1 | M | EUR | 4.10 | EUR | 3.20 |
| RWE | RWEG.DE | 2 | H | EUR | 64.00 | EUR | 63.87 |
| E.ON | EONGn.DE | 1 | H | EUR | 33.00 | EUR | 26.52 |

Source: Citi Investment Research and Analysis, prices as of January 28th

# Company Narratives

# 6. Company Narratives

## ENEL SpA

### Company description

ENEL is a vertically-integrated utility, its operations ranging from generation and import of electricity to distribution and supply to eligible and non-eligible customers. ENEL also distributes and supplies gas and is building an LNG terminal with capacity of 6-8bcm pa that should come on line towards the end of 2012. Its operations span from Italy to Spain, Russia and Latin America, although it has a presence in North America via its renewable subsidiary

### Investment strategy

We rate the stock Hold/Medium Risk (2M). We think ENEL benefits from part of its assets being fully regulated (distribution of electricity and gas) thus guaranteeing the company a continuous and reliable stream of cash flow, whilst the deregulated part of its business (generation of electricity) benefits from a relatively protected market in which, despite new capacity being built, ENEL should be able to maintain power prices at attractive levels. Also forward sales of electricity in all countries where ENEL is present lend further visibility to earnings. Going forward, ENEL aims to rationalise its capex plan, cut costs in Italy and abroad, while disposals of some peripherals assets may also occur in order to further reduce the debt burden

### Valuation

We have a target price of €4.30. We use a sum-of-the-parts methodology. For the Generation & Energy Management (GEM) division, we use a DCF model to value ENEL's power stations and these are benchmarked against European utilities trading multiples. For the Network and Sales (NS) division, we use a RAB-based approach. This consists of a DCF model for two regulatory periods whereas for WACC we use the return allowed by the regulator (7% real pre-tax). Finally for the International and Service division, we use EV/EBITDA multiples of the European utilities sector. For Endesa we also value generation with a DCF model while for regulated assets we simulate the future development of tariffs in Spain. The application of these methodologies returns a fair value for ENEL of €4.80 per share. However, we set our target price at a discount which we believe aptly reflects the execution risks from the integration of Endesa and the high level of debt

### Risks

We rate ENEL Medium Risk because of the following factors that may prevent the share from achieving our target price. With regards to ENEL, we would highlight, in particular, regulatory risk and the possibility that execution risks connected with recent acquisition of Endesa, could increase stock price volatility, in our view. Its high level of debt could also pose a risk to the target price. Finally, ENEL has a strong presence in the market for generation of electricity, for which prices are expected to fall in the future, although the magnitude of such decline is not known. Were power prices to fall faster and deeper than we expect, this could hit the profitability of the company. Other risks stem from ENEL's presence in Spain where political intervention in regulated and deregulated assets is a possibility while delays in the liberalisation of the Russian market could affect future profitability. As some of these risks could surface over the next few months, it could potentially prevent ENEL's share price from reaching our target price. On the upside, a rebound of commodities and power prices could lead to higher margins on coal and hydro stations than we currently expect, thus pushing the share price above our target.

# Iberdrola Renovables

### Company description

IBR is the worlds largest renewables player. The company produces electricity from renewable technologies, mostly wind, but mini-hydro and solar as well. It operates 10.4GW (Sep09). The company also runs 606MW of thermal power plants in the US, gas storages (1.36bcm property, 2.3bcm managed) and an Energy trading division. The company has international exposure; it is number one in Spain and the UK, number two in the US market and has a strong presence in another 20 countries.

### Investment strategy

We rate IBR as Buy/Medium Risk (1M). We see IBR as a growth company (EBITDA CAGR in 2009-13E of 21%) in an attractive sector. Its income is mainly regulated, and now almost 100% hedged for coming two years and its growth is supported by the expected installation of 1.5GW in wind in 2009, 1.8GW in 2010, with 2.1GW forecast beyond this period. We expect c.50% to be installed in the US market. The company's track record and its link to Gamesa through its parent company which ensures the security of supply of turbines (it is 100% hedged for 2009 and 2010, and 80% hedged for 2011 and 2012) make us think these ambitious targets are achievable.

### Valuation

Our target price of €4.1 is chiefly derived from a wind farm valuation on a country basis using a DCF model. According to our calculations, up-and-running assets explain almost 80% of the total valuation, something which in our opinion reduces the company's risk profile as these assets have a secure regulation for all their useful lives. At our target price, IBR would trade at a high 2010E EV/EBITDA of 14.7x and P/E of 37.3x, which we see as justified by expected growth and the wide asset installation.

For Spain (40% of our total valuation), we use a 6.5% WACC to reach an average valuation of €1.5m/MW (blended multiple). In the US (36% of total valuation), we use a 7.0% WACC to reach a valuation of €1.50m/MW.

### Risks

We rate IBR as Medium Risk based on our assessment of the industry- and company-specific risk factors. The following risks could prevent the shares from achieving our target price.

Regulatory risk: The valuation is sensitive to regulatory frameworks and negative developments would affect the shares, although we do not currently expect any changes.

Investment cost inflation: Rising costs could affect profitability but the company is pretty well hedged until 2012 and we see it more as an upside.

We also see some positive risks: i) company outperformance in terms of load factors, or lower operation & maintenance costs; ii) credit market improvement, where better conditions could positively affect forward projects WACC and iii) a more favorable wind turbine scenario could reduce investment costs and therefore increase returns.

# EDP Renovaveis

### Company description

EDPR, a 100% renewables company, is the world's fourth-largest wind generator. The company produces electricity from wind technology. EDPR owns 4.8 GW net (September 2009). The company has a wide international exposure, though it is mainly focused on two markets: Iberia, the pillar for expansion; and the US, the company's growth engine.

### Investment strategy

We rate EDPR Hold/Medium Risk (2M). Although we see EDPR as a growth company (EBITDA CAGR in 2009-13E of 26.5%) in an attractive sector the current valuation does not offer upside to justify a buy rating. Its income is mainly regulated and its growth is supported by the net yearly installation of almost 1.3GW of wind. We expect 50% of new assets to be installed in the US market, one of the most attractive markets due to the level of return and quality of the resource (2009 expected load factor 34%). The company's track record and existing security of supply of turbines make us think these ambitious installations targets are achievable.

### Valuation

Our price target of €7.7 is chiefly derived from a wind farm valuation on a country basis using a DCF model. According to our calculations, up and running assets explain 81% of the total valuation, something which in our opinion reduces the company's risk profile as these assets have a secure regulation for all their useful lives. At our target price, EDPR would trade at a high 2010E EV/EBITDA of 15.3x and Adj. P/E of 51.1x, justified by growth and average wind farm load factors above the sector average.

For Iberia (43% of our total valuation), we use a 6.75% WACC to reach an average valuation of €1.5m/MW (blended multiple). In the US (48.4% of total valuation), we use a 7.5% WACC to reach a valuation of €1.55m/MW.

### Risks

We rate EDPR Medium Risk based on our assessment of the industry- and company-specific risk factors. Some risks that could drive the shares below our target price are the following. i) Execution risk, the expected yearly installation is ambitious and although we think it is achievable, EDPR could be penalised if it does not deliver. ii) Regulatory risk, the valuation is very sensitive to regulatory frameworks, which we do not expect to be modified and iii) Power price risk, as it is not fully hedged vs power prices .

There are also some positive risks: i) company outperformance in terms of load factors, or lower operation & maintenance costs; ii) high electricity prices would have a positive impact on the valuation; iii) outperformance in terms of delivery or potential installation target increase; and v) investment cost deflation: raw materials decrease and suppliers competitiveness is having a negative effect in turbines price.

# E.ON AG

### Company description

E.ON is one of the four dominant power generators in Germany, and it supplies some 7.5m customers with electricity. The company's Ruhrgas subsidiary is the largest importer of gas into Germany. E.ON also has operations in the electricity and gas markets in the UK, in the US and in the Nordic regions.

### Investment strategy

We rate E.On Buy/High Risk (1H). We believe E.On remains a stock worth buying for the following reasons: 1) E.On remains at a significant P/E discount to the sector; 2) fundamental of German markets are sound with limited risks of over capacity in the long term; and 3) streamlining of corporate structure could add further upside.

### Valuation

We use a sum-of-parts method to derive our target price of €33, applying a variety of valuation techniques to the various divisions. We rely chiefly on a mix of DCF valuations, regulatory asset basis and EV/EBITDA multiples. Financial assets are taken at book value, save for the stake in Gazprom, which is marked to market. Nuclear liabilities are subtracted at a value generated by a separate DCF model. Pension provisions are deducted at book value and a portion of the book value of "other" provisions is also subtracted. Our latest SOTP valuation is €35/share on a standalone basis but we apply a discount to set our target price to account for high equity risk premium and volatility of commodity prices.

### Risks

We rate E.On as High Risk based on our assessment of industry- and company-specific risk factors. Risks that may affect the achievement of our target price include the possibility that power prices might fall, as well as regulatory risks in both the gas and the electricity markets. With regard to the investment thesis and achievement of our target price, these could be undermined by renewed competition in German generation or by regulatory change proving more severe than we anticipate. In addition, E.On may still make value-destructive acquisitions.

# RWE AG

### Company description

RWE is the second largest German utility by market capitalisation. It is one of the four dominant power generators in Germany. RWE also owns an electricity business in the UK and various operations in eastern Europe. It is in the process of selling its water business.

### Investment strategy

We rate RWE as Hold/High Risk. RWE is set to invest in generation in coming years to substitute aging existing capacity and this should lower its average cost of generating electricity. Also it has undertaken a €1.2bn cost cutting programme due to be completed by the end of 2012. While we are confident these actions will translate into profits over the next five years, RWE remains exposed to adverse movements in $CO_2$ prices while the recent acquisition of Essent poses some risks as to the successful integration of the newly acquired assets. RWE is also one of the most exposed utilities in Europe to commodity prices that we see moving to lower levels in the near term.

### Valuation

We use a sum-of-parts method applying a variety of valuation techniques to the various divisions. For the key German electricity business we use discounted cash flow for generation and use comparable company analysis to value the networks. We apply a mix of EV/EBITDA multiples, RABs and other benchmarks to the other businesses. Financial assets are taken at book value, while nuclear liabilities are subtracted at a value generated by a separate discounted cash flow model. Pension provisions are deducted at book value and a portion of the book value of ‘other' provisions is also subtracted. Our latest sum-of-parts valuation is €76/share but we apply a discount to account for high equity risk premium and volatility of commodity prices hence we derive a target price of €64 per share.

### Risks

We rate RWE as High Risk, having considered company-specific risks as well as historical share price volatility, based on the input of the Citi quantitative research team, as a possible indicator of future stock-specific risk. Risks that may affect the achievement of our target price include: We see downside risk to earnings if German power prices fall materially. RWE also faces political and regulatory risks. Market share loss in RWE's German retail business could also become a problem if it continues. Finally, we see execution risk on RWE's large capex plan and successful integration of recently acquired assets. If any of these factors proves to have less of an effect than we anticipate, the stock could materially outperform our target.

## Scottish & Southern Energy PLC (SSE.L; £11.69; 1L)

### Company description

SSE generates, transmits, distributes and supplies electricity to industrial, commercial and domestic customers across the UK. SSE is also involved in gas distribution, supply and storage. The company has operations in utility contracting, connections and telecoms.

### Investment strategy

We rate SSE Buy/ Low Risk (1L). Our £13.80 Target Price is 12.5x FY10E and 11.3x FY11E earnings, which is a small premium to the sector, however with the SSE share price’s proven defensive properties and significant earnings growth expected from FY11 based upon an increase in renewables generation capacity, we believe this is a price worth paying now.

### Valuation

We have set a target price of £13.80/share for SSE based on a long-term fundamental valuation, which values SSE's thermal generation assets at £320-491/kW, renewables at £2,525/kW, retail customers at £159/cust (including SME), and the regulated businesses at a 5.5-10.9% premium to RAB. At

£13.80, SSE would trade at 12.5x P/E FY10E and 11.3x P/E for FY11E, slightly above the sector average but reflective of SSE's forecast earnings growth.

### Risks

We rate SSE as Low Risk based on our assessment of industry and company-specific risk factors. Key risks to our target price include: 1) SSE's G&S business is likely to be a key driver of growth. We believe SSE has a high degree of control over earnings in this division, although movements in commodity prices will still have an impact. Higher-than-expected electricity/gas prices could lead to upside if SSE can pass these through to customers. If commodity prices fall, earnings growth could flatten depending on how quickly retail prices come down. 2) SSE will have regulatory reviews affecting its electricity transmission and gas distribution businesses in the next two years. There is uncertainty over future allowed returns and capital expenditure requirements, which will affect earnings growth. 3) SSE is a potential acquisition target and could itself become involved in M&A, including branching out into new areas such as water distribution.

## EDF Energies Nouvelles

### Company description

EDF Energies Nouvelles is a renewable energy company focused on Wind and Solar energy development. It also has operations in hydro and traditional thermal generation as well as research, construction and operation of wind and solar farms. The company was spun out from EDF in 2006 with EDF retaining 50% ownership. The Mouratoglou Group also owns 25.1% of shares in issue.

### Investment strategy

We rate EDF Energies Nouvelles as Hold/High Risk (2H). In our view, EDF Energies Nouvelles is well positioned in its core markets and sectors and should benefit from a global focus on renewable energy in coming years. Accommodating regulatory environments should provide opportunities to generate strong shareholder returns in the current environment. However, most of the potential value generation for EEN is based on pipeline projects for which risks remain over both construction and future regulatory changes and therefore, we think the current valuation fairly reflects the risk reward on future projects.

### Valuation

We have set a target price of €37 per share for EDF Energies Nouvelles. We attempt to capture the probability of differing outcomes in our valuation, where we take a conservative stance more so in keeping with sector-wide practices rather than on doubts of EEN's ability to deliver. Our target price assumes a 70% probability of no value creation/destruction beyond existing assets installed and a 30% probability of full delivery of targets as per our earnings model. We use a blended cost of capital of 5% derived from the individual rates of 4.4% for existing assets and 7.1% for new assets. The main reason for this spread is the credit premium we have incorporated to take account of the current credit environment.

## Risks

We assign EDF Energies Nouvelles a High Risk rating based on our assessment of the following risks. On balance we believe that risk is skewed to the upside due to the company's strong track record in construction and operation of wind farms. The key downside risks are: 1) Potential regulatory remuneration reductions 2) commodity price exposure in construction costs 3) low free float and minority position for public equity investors. If the impact on the company from any of these factors proves to be more negative than we anticipate, the stock will likely have difficulty achieving our financial and price targets. However, if any of these factors proves to have less of an effect than we anticipate, the stock could materially outperform our target.

# Appendix A-1

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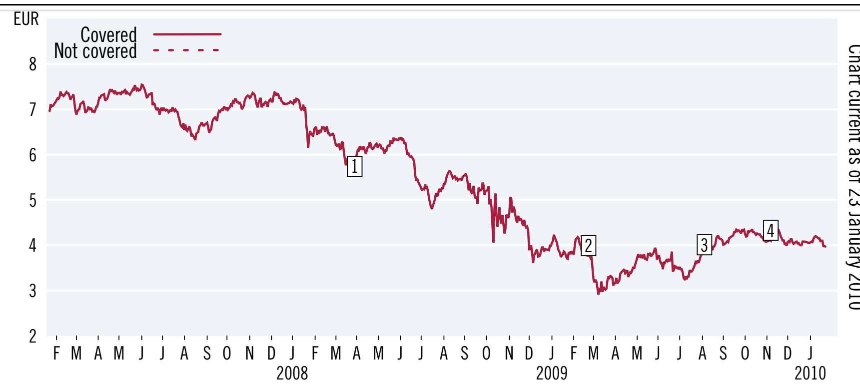
**Ratings and Target Price History**

**Fundamental Research**

Analyst: Alberto Ponti




| Date | Rating | Target Price | Closing Price |
|---|---|---|---|
| 1 28-Mar-08 | 1M | *6.79 | 5.92 |
| 2 23-Feb-09 | *1H | *4.41 | 3.81 |
| 3 5-Aug-09 | *1M | *4.30 | 3.80 |
| 4 6-Nov-09 | *2M | 4.30 | 4.10 |

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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|---|---|---|---|
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