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Industry View
Cautious

Utilities: South European Generators

No Sign of Recovery; Downside Risk to Valuation

No sign of recovery in Italy and Spain. In April, electricity demand (adjusted for calendar and temperatures) declined by 10.8% in Spain, accelerating from an already difficult 1Q09 (-8.9%). Gas demand in Spain is also very weak, plummeting 17.3% in 1Q. Italy is not faring much better: electricity demand contracted by 7.9% in 1Q and gas by 7%. Consensus was expecting some bad news on this front, but we believe the extent of the decline in both countries paints a far gloomier picture than has been priced in to date.

Demand destruction leads to long-term overcapacity; rally in spark spreads unjustified. We expect Spanish reserve margins to grow to 40% in 2010 and remain at these levels until at least 2013 as capacity payments discourage the mothballing of CCGTs. In Italy, CCGTs under construction and the development of renewables should lead to an increase in capacity installed over the next few years. Spark spreads have recovered in both countries since the beginning of the year. Worsening demand and a bleak import outlook are likely, we think, to add pressure in the coming months.

Cautious on Iberia – move to EW on Iberdrola and UW on Gas Natural; Endesa now our top pick. We see some 11% downside risk to consensus earnings for Iberian generators and think poor summer electricity prices will put pressure on share price. We prefer the North European players, in particular RWE and SSE. We are downgrading IBE to EW and cutting our price target to €7.3 given our lower expectation of a recovery in Spanish spark spreads in the short term. On the same basis, we downgrade GAS to UW with an updated earnings model and price target of €12.1. ELE offers some value supported by a strong dividend yield.

GICS Sector: Utilities

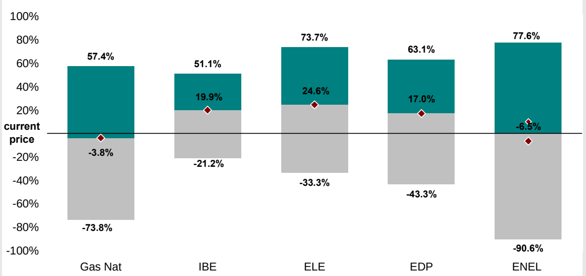
Strategists' Recommended Weight	6.9%
MSCI Europe Weight	6.9%

What's changed

Endesa (ELE.MC, €17.10)	Stay OW, PT from €23.6 to €21.3
Iberdrola (IBE.MC, €6.09)	OW to EW, PT from €8.1 to €7.3
EDP (EDP.LS, €2.82)	Stay EW, PT from €3.2 to €3.3
ENEL (ENEI.MI, €4.28)	Stay UW, PT €4.0
Gas Natural (GAS.MC, €12.58)	EW to UW, PT from €18.3 to €12.1

Source: Morgan Stanley Research estimates

Iberian generators: downside risk still large



Source: Morgan Stanley Research estimates

South European Generators: Oversupply to Last in the Long Run

We are lowering our estimates for Spanish and Italian generation prices in the medium term. Demand signals are much worse than expected and overcapacity in Southern Europe looks set to increase substantially, with reserve margins pointing to 40% in Spain and 30% in Italy in 2010. We do not see a way out in the short term: plants in Italy and Spain are new and renewables development and projects under construction could even worsen the situation until 2011. Given the imbalance in demand/supply, we believe the recent improvement in spark spreads will prove short-lived and see downside risk to consensus estimates for both Iberian and Italian generators.

Cutting our estimates. We are lowering our 2009-13 EPS estimates by 6.6%, on average, for the Italian and Iberian generators (EDP, ENEL, ELE, IBE, GAS) as we now assume lower production volumes and lower spark spreads. On our new estimates (and excluding renewables), the sub-sector trades on a 2010 EV/EBITDA multiple of 6.9 – an 11.9% premium to the sector, which we regard as unjustified.

Remain OW on Endesa – our top pick in this space. The share price appears to discount the negative dynamics of the Spanish generation market, and we see the strong dividend yield as a support for the stock.

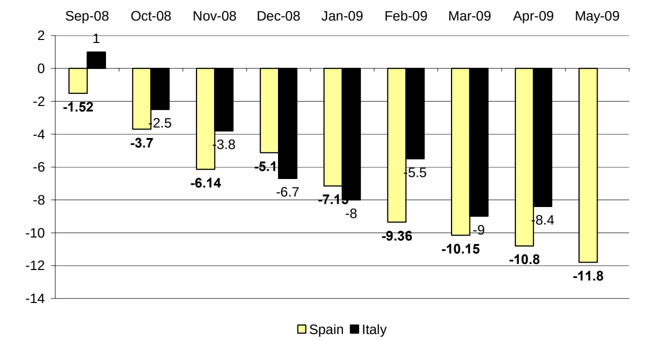
Downgrading Iberdrola to EW. We think Iberdrola remains least exposed to the collapse in Spanish demand, given its significant exposure to hydro, nuclear and wind power. Also, diversification in regulated assets provides some long-term earnings visibility. That said, we think the group's debt remains a concern, and short-term EBITDA deterioration due to lower power prices in Spain could put pressure on the company's credit rating. We also see downside risk to consensus earnings (-8% in 2009-11) as the market is still not discounting the prolonged difficulties of Spanish generation.

Still EW on EDP. While its short-term earnings are protected by the company's Portuguese long-term contracts (CMCS), the stock offers modest upside potential, in our view, and the share price already discounts a recovery in the Iberian market.

ENEL and Gas Natural: large downside risk on our bear cases – Underweight. We downgrade Gas Natural to UW and reiterate our UW rating on ENEL. Given their relatively high gearing and exposure to thermal generation, we believe the two groups are particularly exposed to the economic cycle in Spain and Italy. We still see downside risk to consensus earnings and company guidance.

Exhibit 1

Iberian/Italian collapse in demand is accelerating



Source: REE and TERNA

Demand destruction continues in Spain and Italy

Our analysis of monthly demand data for electricity (adjusted calendar and temperature) shows a continued deterioration, with April demand contracting by 10.8% in Spain and by 8.4% in Italy. Both figures are worse than the sharp decline already seen in 1Q.

In this context we are cutting our 2009 demand growth forecasts from -3% to -6.5% in Spain and from -2.5 to -5.5% in Italy. In line with our economists' view on GDP, we see a moderate recovery in electricity demand in Italy in 2010 and a further decline in Spain. The impact of lower demand on national production is likely to be amplified in both countries by a weak import market. In Spain, we expect exports to Portugal to decline, and in Italy we anticipate a substantial rise in imports from France. Therefore, we now expect Spanish production to decline by 7.7% in 2009 and Italian production to decline by 7.5%. Production volumes achieved in 2008 are unlikely to be reached again within the next five years, we believe.

Exhibit 2

Spanish electricity demand: no recovery in 2009 or 2010

(TWh)	2008	2009e	2010e	2011e	2012e	2013e
Electricity Demand	279.8	261.6	259.1	261.8	264.5	267.2
Change (%)	1.2	-6.50	-0.9	1.0	1.0	1.0
Services & losses	12.1	11.3	11.2	11.3	11.4	11.5
Total request	**291.8**	**272.9**	**270.3**	**273.1**	**275.9**	**278.7**
Change (%)	**0.8**	**-6.5**	**-0.9**	**1.0**	**1.0**	**1.0**
Imports (exports)	(11.0)	(7.0)	(7.0)	(7.0)	(7.0)	(7.0)
National production	286.9	265.0	262.4	265.0	267.5	270.1
Change (%)	2.6	-7.7	-1.0	1.0	1.0	1.0

e = Morgan Stanley Research estimates Source: Company data, Morgan Stanley Research

Exhibit 3
Italian electricity production under pressure as imports pick up

(TWh)	2008	2009e	2010e	2011e	2012e	2013e
Total consumption	316.5	299.1	302.1	305.1	308.1	311.2
Change (%)	-0.7	-5.5	1.0	1.0	1.0	1.0
Services & losses	39.8	40.0	39.0	39.4	39.8	40.2
Total request	**356.3**	**339.1**	**341.1**	**344.5**	**347.9**	**351.4**
Change (%)	**-0.8**	**-4.8**	**0.6**	**1.0**	**1.0**	**1.0**
Imports net	39.6	46.0	43.7	41.5	39.4	37.5
National production	316.7	293.1	297.4	302.9	308.5	313.9
Change (%)	1.0	-7.5	1.5	1.9	1.8	1.8

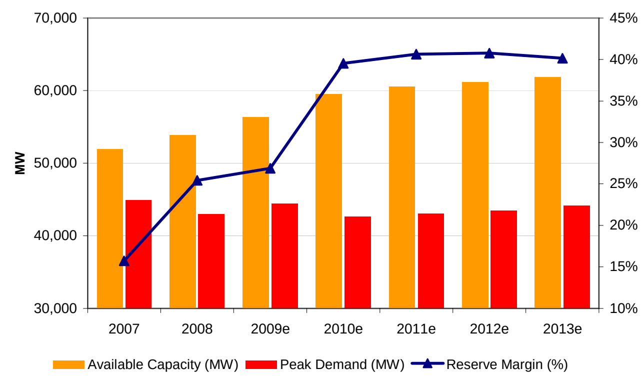
e = Morgan Stanley Research estimates   Source: Company data, Morgan Stanley Research

Despite the reduction in production, capacity installed is still increasing in both Italy and Spain, where some 6GW and 4GW, respectively, are under construction. We expect capacity installed to grow modestly, given the continued development of renewables, whereas we assume that all projects for thermal generation not yet under construction will be cancelled. On the back of this, we see reserve margins in both countries increasing substantially by 2010 – to 40% in Spain and 35% in Italy. Considering our weak demand growth expectations, growth in capacity installed and limited plant closures, we expect overcapacity to persist in the medium to long term.

The demand/supply balance in Southern Europe is characterised by overcapacity, which we think is likely to prevail in the medium to long term.

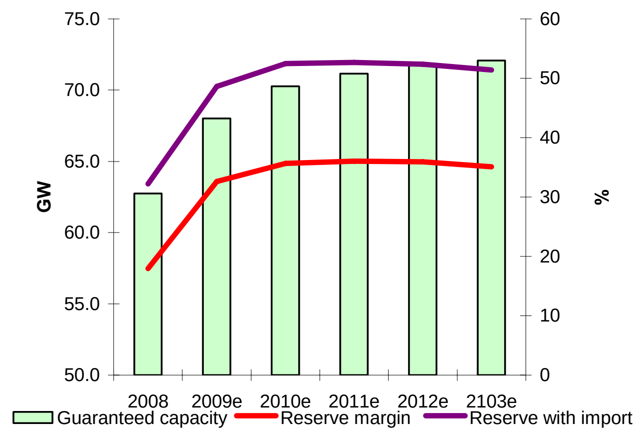
Overcapacity is likely to affect the CCGT load factor, which we see running at a very low average in both Italy and Spain. In Spain, we expect that, as a consequence of the weak demand, reduction in exports and increase in capacity installed, the CCGT load factor will hit a trough of to 31% in 2009 and will decline below 25% thereafter.

Exhibit 4
Spanish reserve margin to reach 40% in 2010-13e



e = Morgan Stanley Research estimates   Source: Company data, Morgan Stanley Research

Exhibit 5
Italian reserve margin above 30% in 2009e



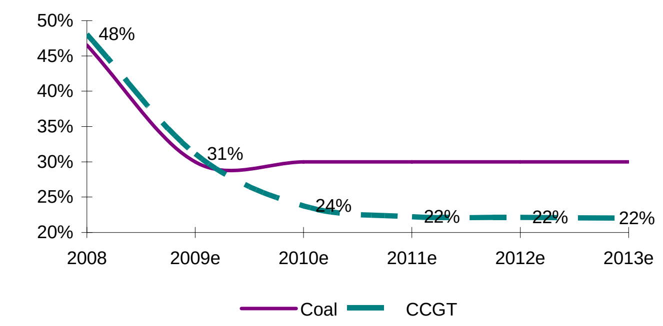
e = Morgan Stanley Research estimates   Source: Company data, Morgan Stanley Research

This will happen despite the temporary closure of some of the coal generation plants, we believe. This scenario would suggest some action from the industry, leading to early closure of plants or mothballing. We think, however, that this is unlikely. In fact, the capacity payments available in Spain are still relatively attractive and are sufficient to prevent closures. The consequence of this, in our view, is that the overcapacity will remain in the medium term, affecting prices.

The Italian situation is not that different, we think, with the average CCGT load factor likely to be lower than 40% in 2009. In Italy, even if the average load factor were higher than in Spain, companies' generation mix would be less diversified (no nuclear production), so the pressure on margins arising from the weak load factor and pressure on spreads would remain very high.

Exhibit 6

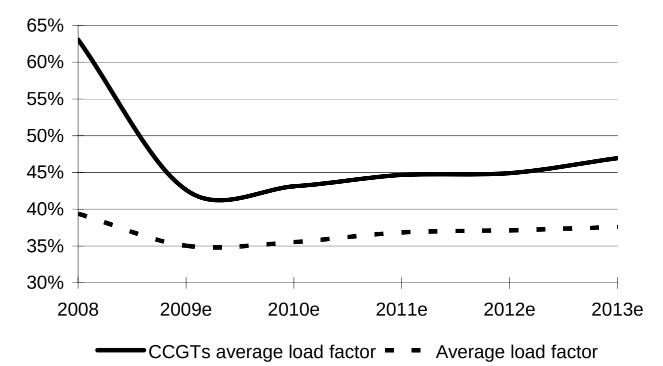
Spanish CCGT load factor below 30%



e = Morgan Stanley Research estimates Source: Company data, Morgan Stanley Research

Exhibit 7

Italian CCGT load factor under huge pressure in 2009



e = Morgan Stanley Research estimates Source: Company data, Morgan Stanley Research

On our new demand/supply assumptions, any margin improvement in Spain is unlikely over the next four years.

We estimate that the average clean spark spread in Spain has remained below €3/MWh over the last few years – a level well below that for new entrants (€14.3/MWh, on our estimates). On top of the demand/supply balance, spark spreads in Spain are affected by the price of coal relative to gas, and by hydro and wind conditions. This creates volatility in spreads. That said, we do not see a structural recovery of spreads over the next four years and expect profitability to remain weak (but sustainable) for CCGTs. On our new estimates, average clean spark spreads reach €3/MWh over 2009-12. Considering the capacity payments available in Spain (€20.000/MW) and the 'restriction market' (the premium paid for capacity availability in bottleneck areas), we believe that the total achieved average spark spread for Spanish generators should be around €8/MWh – low but sustainable, and significantly below new-entrant levels. This, in our view, is fully justified given the overcapacity within the system.

We assume that spreads will reach new-entrant levels in 2013. This assumption is challenged by the future rules on capacity payments, Phase 3 of ETS rules and long-term commodity assumptions.

Exhibit 8

Improvement in spark spreads in Spain would be unjustified, given structural and growing overcapacity

	2007	2008	2009e	2010e	2011e	2012e	2013e
€/US$	1.35	1.35	1.32	1.32	1.32	1.32	1.35
Oil Price ($/bbl)	71	100	50	63	68	71	84
Gas Price (€/'000 cm)	250	332	204	239	253	260	269
Coal ($/ton)	133	140	75	85	92	96	85.0
CO_2 (€/Ton)	3.00	22	14	15	15	15	20.0
Clean Spark spreads (€/MWh)	-0.9	2.5	3.0	3.0	3.0	3.0	14.3
Generation Price (€/MWh) – Spain	**43.0**	**65.6**	**41.8**	**47.6**	**50.2**	**51.4**	**65.0**

e = Morgan Stanley Research estimates Source: Company data, Morgan Stanley Research

Exhibit 9

Italian spark spreads below new-entrant levels in 2009-12e

	2007	2008	2009e	2010e	2011e	2012e	2013e
€/US$	1.35	1.35	1.32	1.32	1.32	1.32	1.35
Oil Price ($/bbl)	71	100	50	63	68	71	84
Gas Price (€/'000 cm)	250	336	230	240	254	261	263
Coal ($/ton)	96	140	75	85	92	92	85
CO2 (€/Ton)	2.0	23.0	14.2	14.8	15.4	15.3	20.0
Clean Spark spreads (€/MWh)	22.5	17.0	11.0	8.0	8.0	8.0	14.3
Emission Costs (€/MWh)	0.8	7.8	5.0	5.2	5.4	5.3	7.0
base load Price (€/MWh) – Italy	**67.8**	**80.9**	**58.0**	**53.0**	**55.5**	**56.7**	**65.0**

e = Morgan Stanley Research estimates

Source: GME, Morgan Stanley Research

In Italy, we expect spreads to fall sharply from 2007-08 levels, due mainly to the substantial increase in supply and the collapse of demand. We expect 2009 to be the first competitive year for the Italian market.

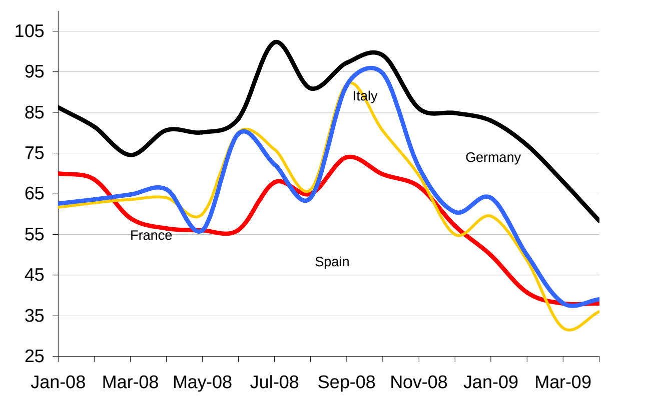
We expect Italian electricity prices to average €58/MWh in 2009 (€71.6/MWh so far this year) and to contract to €50-55/MWh before the summer. This would imply an average clean spark spread of €11/MWh – well below the €17/MWh registered in 2008. Sector profitability is under considerable pressure, considering the 7.5% reduction in volumes produced that we expect for 2009. The exceptionally good hydro generation conditions and some forward sales should, however, soften the impact of competition on company profits in 2009. We expect margins to contract further in 2010 with the increase in reserve margins and persistent pressure on CCGT load factors.

To facilitate comparison, our estimates do not include additional costs arising from ‘green certificates’. This year, Italian conventional producers and importers will have to buy ‘green certificates’ equivalent to 5.3% of their production (this percentage will increase by 0.75% per year until 2012). Given the current cost of these certificates (€80/MWh), this mechanism should increase reported prices by c.€4.2/MWh.

In this context, we think the recent increase in spark spreads seen mainly in Italy (but also in Spain) is unjustified, and expect renewed pricing pressure in the short term.

Exhibit 10

Electricity spot prices are plummeting in Europe

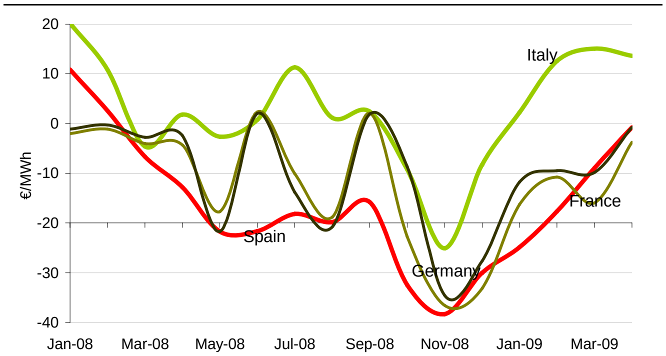


Source: Bloomberg, Omel, GME, Morgan Stanley Research

Over the last few months, electricity prices in Europe have fallen sharply. Nevertheless, given the reduction in oil and CO_2 prices, we estimate that, in April, spark spreads in Italy and Spain returned to a level in line with spring 2008, or higher. Given the rapidly deteriorating demand/supply balance, we believe this will prove short-lived and we expect pressure on prices in the short term.

Exhibit 11

Spark spreads are improving in Italy and Spain, despite weak demand and overcapacity



Source: Morgan Stanley Research

Iberian Utilities: Still Large Downside Risk to Bear Case

Lower load factor and lower spark spreads lead to an average 6.6% cut in EPS for South European generators

Exhibit 12

Average 4% cut in EBITDA on lower energy prices and production volumes …

EBITDA (€mn)	2009e	2010e	2011e	2012e
EDP				
Old	3199	3355	3525	3767
New	3155	3293	3459	3675
Change (%)	-1.4	-1.8	-1.9	-2.4
Endesa				
Old	6493	6352	6351	6699
New	6556	6281	6140	6452
Change (%)	1.0	-1.1	-3.3	-3.7
ENEL				
Old	15016	14306	14493	15106
New	15030	14551	13830	14293
Change (%)	0.1	1.7	-4.6	-5.4
Gas Natural				
Old	4555	4436	4644	4859
New	3967	4055	4253	4406
Change (%)	-12.9	-8.6	-8.4	-9.3
Iberdrola				
Old	7309	7698	8306	8961
New	7128	7563	8002	8749
Change (%)	-2.5	-1.7	-3.7	-2.4

Source: Morgan Stanley Research estimates

Exhibit 13

… and a 6.6% cut to earnings estimates, on average, over 2009-12e

Net Income (€mn)	2009e	2010e	2011e	2012e
EDP				
Old	857	905	930	1066
New	856	839	853	961
Change (%)	-0.2	-7.3	-8.3	-9.8
Endesa				
Old	2220	1980	1863	2026
New	2226	2022	1757	1885
Change (%)	0.3	2.1	-5.7	-7.0
ENEL				
Old	3813	2910	2924	3145
New	3673	3041	2515	2423
Change (%)	-3.7	4.5	-14.0	-22.9
Gas Natural				
Old	1446	1202	1293	1411
New	1365	1148	1211	1340
Change (%)	-5.6	-4.5	-6.4	-5.1
Iberdrola				
Old	2698	2867	3151	3512
New	2517	2677	2823	3212
Change (%)	-6.7	-6.6	-10.4	-8.5

Source: Morgan Stanley Research estimates

Given our expectation of a difficult outlook for the Spanish and Italian generation market, we are turning very cautious on Iberian utilities. Our new estimates lead us to cut our target prices by 10%, on average. We see Endesa as the sole potential outperformer in the group. We downgrade Iberdrola to EW and Gas Natural to UW, and remain cautious on ENEL (UW). Among the European utilities, we prefer the Northern European players, and in particular RWE and SSE.

Exhibit 14

Downgrading Gas Nat and Iberdrola

	Rating	Price Target
Endesa	Stay OW	From €23.6 to €21.3
Iberdrola	From OW to EW	From €8.1 to €7.3
EDP	Stay EW	From €3.2 to €3.3
ENEL	Stay UW	Unchanged €4.0
Gas Nat	From EW to UW	From €18.3 to €12.1

Source: Morgan Stanley Research estimates

Our negative stance on Iberian utilities is based on three reasons.

1) Still substantial downside risk to consensus earnings
On our new estimates, we see 11% average downside risk to 2009-11 EPS for the Iberian utilities (Exhibit 16) and some 4% downside to EBITDA (Exhibit 15). Downside risk is affecting all Iberian utilities, but we see it particularly large at ENEL (-22.2% on average in 2009-11), given the combination of a poor Spanish and Italian market and high gearing.

2) Iberian utilities trading at unjustified premium to sector
On our new estimates, and stripping out the contribution of IBR from Iberdrola and EDPR from EDP, we estimate that Iberian integrated utilities trade at a 10-15% premium to other European integrated players on EV/EBITDA and in line on P/E (Exhibits 17 and 18). We believe this is unjustified given the higher gearing of Iberian utilities (Exhibit 19) and therefore higher equity beta. Excluding minorities from EBITDA, we estimate that, with the exception of Endesa, the Iberian and Italian utilities' net debt/EBITDA is well above 4x. We also see greater uncertainty over the timing of any spark spread recovery, given the considerable overcapacity in both countries.

3) Risk skewed to the downside
In line with our global oil & gas team, we believe that long-term oil prices will recover to $84/bbl (see *Global Oil Outlook – 2009: The Global Engine, Stalled and Flooded*, February 2, 2009). For European utilities, we assume that oversupply will retreat, allowing for a sustainable long-term load factor (30-40%) and spark spreads in line with new-entrant levels (€14.3/MWh).

Under this base case scenario, which points to electricity prices of €65/MWh (40% above the Spanish forward curve for 2011), we still see limited upside potential for the Iberian generators: just 10.2% on average, compared with 30% for the broader sector.

We see some 52.4% downside risk to our bear case for the Iberian players, however, compared with only 19% downside for the sector. Our bear case hinges on the assumption that electricity prices will remain at €42/MWh in the long run, reveal stronger than sector average volatility in terms of equity valuation – due mainly to the higher than average gearing of the Iberian utilities (Exhibit 19) and their greater exposure to thermal generation, which faces intense competition.

Exhibit 15
Consensus EBITDA is still too high, in our view …

EBITDA (€mn)	2009e	2010e	2011e
EDP			
Consensus	3277	3476	3678
MS	3155	3293	3459
Difference (%)	-3.7	-5.3	-6.0
Endesa			
Consensus	6700	6693	6904
MS	6556	6281	6140
Difference (%)	-2.2	-6.2	-11.1
ENEL			
Consensus	14730	15478	15708
MS	15030	14551	13830
Difference (%)	2.0	-6.0	-12.0
Gas Natural			
Consensus	3769	4108	4411
MS	3967	4055	4253
Difference (%)	5.2	-1.3	-3.6
Iberdrola			
Consensus	7279	7745	8396
MS	7128	7563	8002
Difference (%)	-2.1	-2.3	-4.7

Source: IBES, Morgan Stanley Research estimates

Exhibit 16
… and we see some 11% downside risk to consensus earnings

Net Profit (€mn)	2009e	2010e	2011e
EDP			
Consensus	856	937	957
MS	856	839	853
Difference (%)	-0.1	-10.4	-10.8
Endesa			
Consensus	2635	2173	2146
MS	2226	2022	1757
Difference (%)	-15.5	-6.9	-18.1
ENEL			
Consensus	4025	4018	3864
MS	3673	3041	2515
Difference (%)	-8.7	-24.3	-34.9
Gas Natural			
Consensus	1201	1227	1386
MS	1365	1148	1211
Difference (%)	13.7	-6.4	-12.6
Iberdrola			
Consensus	2716	2901	3099
MS	2517	2677	2823
Difference (%)	-7.3	-7.7	-8.9

Source: IBES, Morgan Stanley Research estimates

Exhibit 17

Iberian utilities trade at an unjustified premium to sector in terms of EV/EBITDA …

EV/EBITDA	2008	2009e	2010e	2011e
EDP (excl. renewables)	6.7	6.7	6.8	6.7
Endesa	5.5	5.8	6.0	6.2
ENEL	6.1	6.2	6.2	6.6
Gas Natural	3.9	8.0	7.6	7.1
IBE (excl. renewables)	9.0	8.0	7.9	7.8
Iberian average	**6.2**	**6.9**	**6.9**	**6.9**
Sector average	**8.2**	**6.4**	**6.1**	**5.9**
Premium (%)	**-24.2**	**9.1**	**12.5**	**17.3**

e = Morgan Stanley Research estimates Source: Company data, Morgan Stanley Research

Exhibit 18

… and P/E

P/E	2008	2009e	2010e	2011e
EDP (excl. renewables)	5.5	7.4	7.9	8.1
Endesa	9.3	8.1	9.0	10.3
ENEL	5.4	9.4	11.3	13.7
Gas Natural	7.2	8.5	10.1	9.6
IBE (excl. renewables)	9.0	8.8	8.4	8.1
Iberian average	**7.3**	**8.4**	**9.3**	**10.0**
Sector average	**11.6**	**9.4**	**9.0**	**8.4**
Premium (%)		**-10.3**	**3.2**	**18.0**

e = Morgan Stanley Research estimates Source: Company data, Morgan Stanley Research

Exhibit 19

Iberian utilities: net debt/EBITDA

Company	Net debt/EBITDA (excluding minorities)			
	2008	2009e	2010e	2011e
RWE AG	-0.1	1.4	1.4	1.4
Centrica	0.2	1.6	1.4	1.1
Scottish & Southern	2.3	2.2	2.3	2.1
Fortum	2.3	2.3	2.4	2.3
GDF SUEZ	2.5	2.4	2.3	1.9
Suez Environnement	2.5	2.6	2.5	2.4
PPC	13.1	3.0	3.3	3.4
EDF	2.7	3.0	2.6	2.3
Endesa	**3.0**	**3.0**	**3.1**	**3.2**
ACEA	2.8	3.1	3.3	3.2
A2A SpA	3.7	3.2	2.7	2.4
International Power	4.4	3.7	3.4	3.2
ENEL	**4.2**	**4.4**	**4.3**	**4.6**
Iberdrola	**5.0**	**4.6**	**4.5**	**4.6**
Gas Natural	**2.0**	**4.6**	**4.2**	**3.8**
United Utilities	3.1	4.6	4.2	5.1
EDP	**4.7**	**4.7**	**4.8**	**4.9**
Veolia Environnement	4.8	5.0	4.7	4.3
Severn Trent	5.0	5.2	4.8	5.3
National Grid plc	5.4	5.3	5.3	5.4
NWG	5.7	5.8	5.7	6.0
Iberian average	**3.8**	**4.3**	**4.2**	**4.2**
Average	**3.8**	**3.6**	**3.5**	**3.5**

e = Morgan Stanley Research estimates Source: Company data, Morgan Stanley Research

Exhibit 20

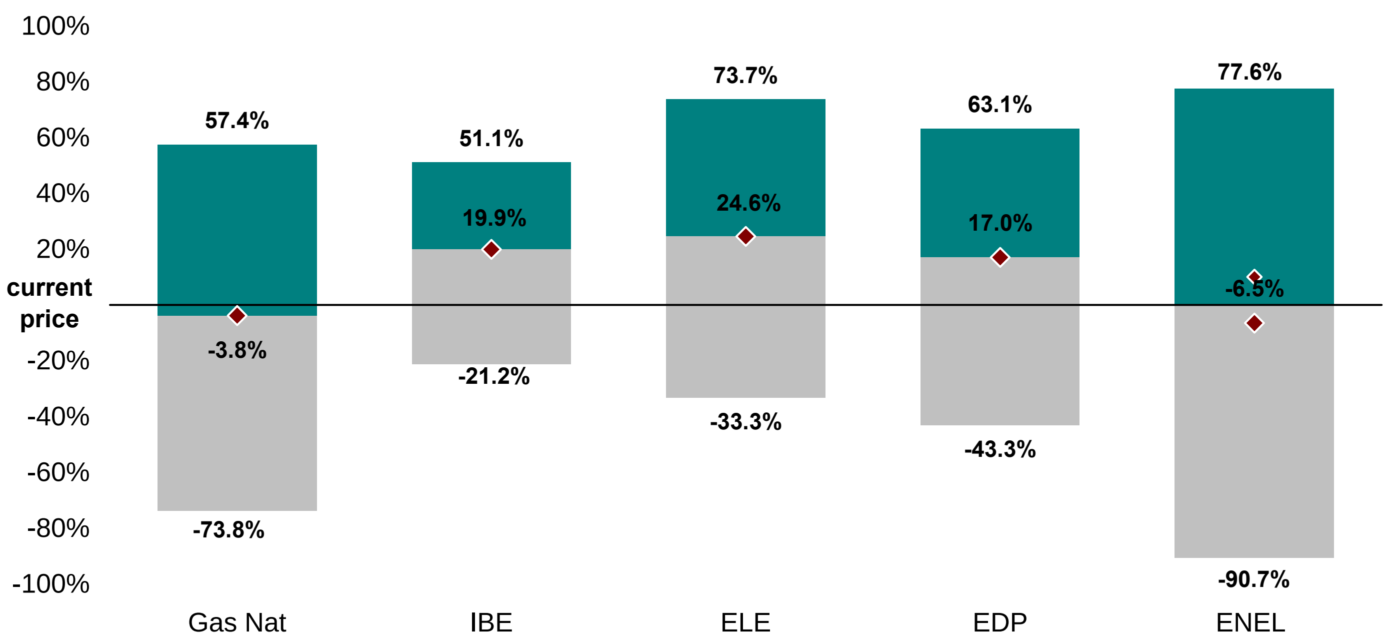
Upside potential limited to Endesa; significant downside risk to our bear case

	Price (%)	Price Target	Bear	Base	Bull	Upside to price target (%)	Upside to Bull case (%)	Downside to Bear case (%)
Gas Nat	12.6	12.1	3.3	12.1	19.8	-3.8	57.4	-73.8
IBE	6.1	7.3	4.8	7.3	9.2	19.9	51.1	-21.2
ELE	17.1	21.3	11.4	21.3	29.7	24.6	73.7	-33.3
EDP	2.8	3.3	1.6	3.3	4.6	17.0	63.1	-43.3
ENEL	4.3	4.0	0.4	4.0	7.6	-6.5	77.6	-90.7
Average						**10.2**	**64.6**	**-52.4**

Source: Morgan Stanley Research estimates

Exhibit 21

Gas Natural and ENEL: significant downside risk in our bear case



Source: Morgan Stanley Research estimates

Endesa: High Dividend, Risks Discounted – Our Top Pick

What's Changed	
Price Target	**€23.60 to €21.30**

Lower gearing, lower risk. Following the securitisation of the tariff deficit (€5bn expected by the summer), the sale of the renewables business to Acciona for €2.89bn (agreement signed in February) and the disposal of the electricity transmission networks in the Balearic and Canary Islands, as required by law, we expect Endesa's net debt to reduce to €12.4bn at the end of 2010, below 2x EBITDA. This low level reduces the risk of exposure to Spanish generation (26% of EBITDA in 2010, we estimate) and should support management's strong dividend policy (60% payout expected).

Weak Spanish market in the price; valuation still compelling. Endesa trades on a 5.8x EV/EBITDA and 8.1x P/E for 2009, on our estimates – 10% below the sector average. We believe this is unjustified, considering the company's lower gearing, strong and visible dynamic of the group Latin American business and a particularly acute negative cycle in Spain, which we expect will recover in the medium term (2012-13).

Strong 2009 results and clarity on dividend should support shares. Thanks to forward sales in both Spain and Latin America, we expect Endesa's results to be affected only modestly in 2009. Forward sales should also protect 2010 EBITDA. We expect the group to discuss the dividend policy and distribute an ordinary dividend of €¢90 in July. This could be an important catalyst, as a higher dividend could be announced than the market expects.

Key Ratios and Statistics

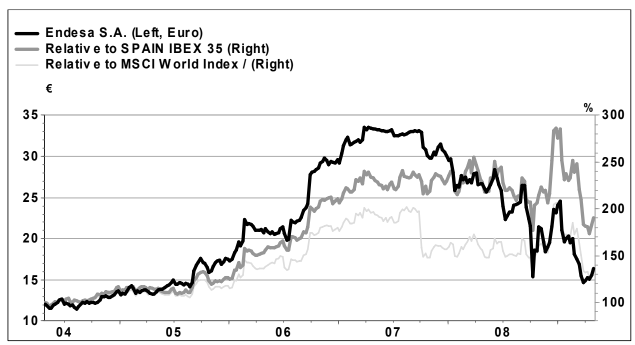
Reuters: ELE.MC Bloomberg: ELE SM
Utilities / Spain

Price target	**€21.30**
Shr price, close (May 6, 2009)	€17.10
52-Week Range	€27.02-13.80
Mkt cap, curr (mn)	€18,105
Net debt (12/09e) (mn)	€17,081
EV (12/09e) (mn)	€38,064

Fiscal Year ending	**12/08**	**12/09e**	**12/10e**	**12/11e**
ModelWare EPS (€)	**2.41**	**2.10**	**1.91**	**1.66**
Prior ModelWare EPS (€)	**2.44**	**2.09**	**1.85**	**1.76**
P/E	**9.3**	**8.1**	**9.0**	**10.3**
Consensus EPS (€)§	**2.31**	**2.12**	**2.02**	**2.04**
Div yld (%)	30.2	10.2	8.3	5.8
Div per shr (€)	6.79	1.75	1.42	1.00
EBITDA (€mn)	6,867	6,556	6,281	6,140
Prior EBITDA (€mn)	6,895	6,493	6,352	6,351
EBITDA, consensus (€mn)	6,963	6,700	6,693	6,904
EV/EBITDA	5.5	5.8	6.0	6.2

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).
§ = Consensus data is provided by FactSet Estimates.
e = Morgan Stanley Research estimates

Price Performance

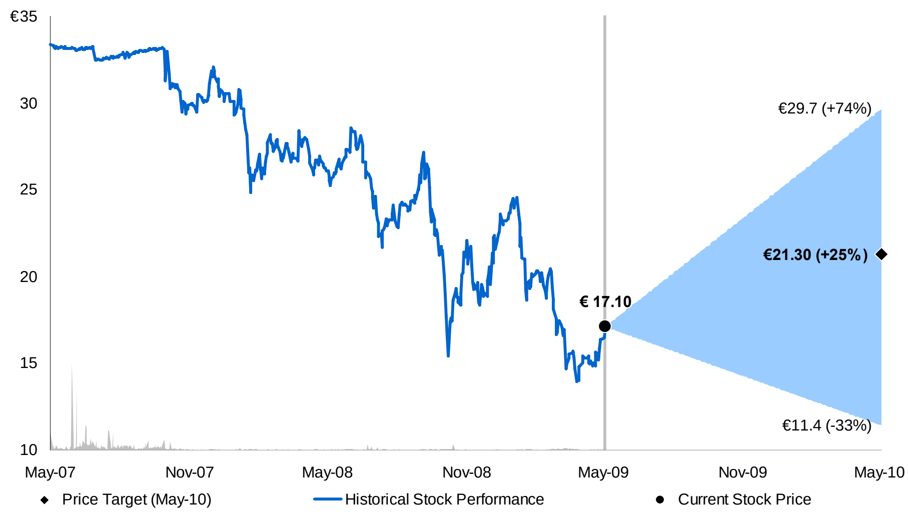


Source: FactSet Research Systems Inc

Company Description
Endesa is the largest Integrated electricity company in Spain with 22GW of capacity installed and 40% of the distribution. Via its 60.4% control of Enersis, Endesa is also the largest European utility company in Latin America, with a presence in Chile, Brazil, Colombia, Peru and Argentina. Following its recent agreement with Acciona, Italian company ENEL controls 92% of the company.

Risk-Reward Snapshot: Endesa (ELE.MC, Overweight, PT €21.3)

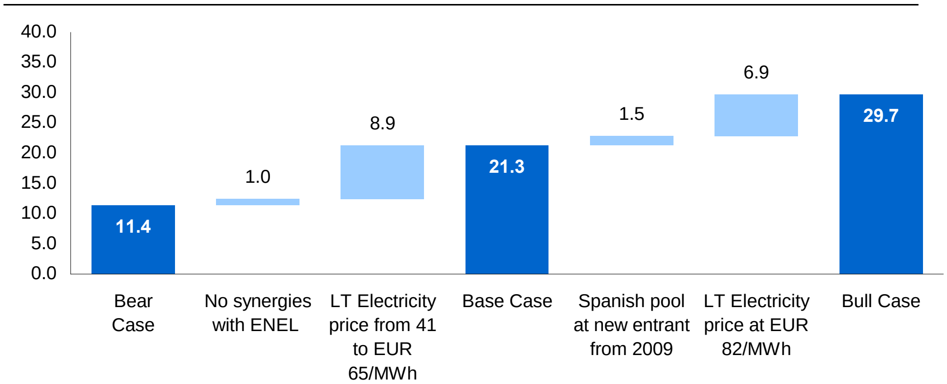
Poor Spanish generation outlook is in the price …



Source: FactSet (historical share price data), Morgan Stanley Research estimates

Bull Case €29.70	8.2x 2010e EV/EBITDA	**Substantial synergies with ENEL, strong Spanish generation and long-term electricity prices at €82/MWh.** For the shares to reach €29.7, we assume generation prices will revert to new-entrant levels from 2009.
Base Case €21.3	6.8x 2010e EV/EBITDA	**Base case discounts three years of tough competition in Spain**, €200mn per year of synergies with ENEL, and cost of debt at 100 bps spread on government bonds.
Bear Case €11.4	5.1x 2010e EV/EBITDA	**Adverse commodity backdrop and failure to develop synergies with ENEL.** We assume that management fails to develop synergies, long-term electricity prices to €41/MWh.

... and share price discounts long-term electricity prices at €54/MWh



Source: Morgan Stanley Research estimates

Why Overweight?

- Owing to its strong balance sheet and a lower than average exposure to hydro and nuclear generation (only 40% of total volumes in 2008), Endesa's exposure to long-term oil prices is relatively low. The company is suffering from the collapse in demand occurring in Spain, but we think its share price already discounts a long-term oil price of $55/bbl, a long-term electricity price of €54/MWh and an 18.4% decline in production volumes in Spain in 2009. On our bear case ELE offers 33% potential downside, which compares with 52% downside, on average, for the other Iberian utilities.
- **Visibility and lower risk command a premium to sector multiples.** The group trades in line with sector multiples, which we believe is unjustified given its defensiveness and lower gearing.

Key Value Drivers

- Oil prices, Spanish pool prices, cost of debt and synergies from the integration with ENEL.

Potential Catalysts

- We expect the group to announce a long-term dividend policy and a detailed business plan over the next few months.
- We expect the Spanish government to define rules to allow the securitisation of the tariff deficit by the summer.

Endesa – Resilient to Downturn

We are cutting our Endesa target price by 9.7% from €23.6 to €21.3 per share; this still implies a healthy 24.6% potential upside and we remain Overweight. Endesa is now our top pick in Spain: valuation is attractive, forward sales should protect EBITDA in the medium term, and disposals and dividends can provide strong catalysts for the shares.

We slightly lower our EBITDA estimates for Endesa to reflect our new assumption of a 6.5% decline in electricity demand in Spain in 2009 (versus our previous estimate of -3%). This should affect reserve margins and add pressure to spark spreads in the medium term. We are lowering our spread assumption from €8/MWh to €3/MWh in 2010-12. These new assumptions only have a modest effect on Endesa. The company has already sold forward 75% of the electricity for 2009 and 25% of its 2010 production. Furthermore, in Latin America, sales of production in Chile are locked into long-term contracts that suggest an average price of $80/MWh.

As a consequence of this policy, our EBITDA and EPS estimates come down by an average of 2.5% and 3.5%, respectively, over 2009-13. Group EBITDA is set to continue to grow modestly from 2008 levels (+3% CAGR 2008-13, we estimate) if we adjust for the effect of announced disposals (the sale of the renewables division to Acciona and sale of the high-voltage networks in the Balearics and Canaries to REE).

Stable EBITDA should also allow the group to improve the efficiency of the balance sheet, increasing its debt levels. Even if we assume a 60% payout (i.e., a 10.2% dividend yield in 2009 and 8.3% in 2010), group debt continues to reduce following the securitisation of the Spanish tariff deficit (government guarantee approved on April 30) and disposals. We therefore believe that Endesa's dividend policy could be improved, which would be a positive catalyst for the stock.

Exhibit 22

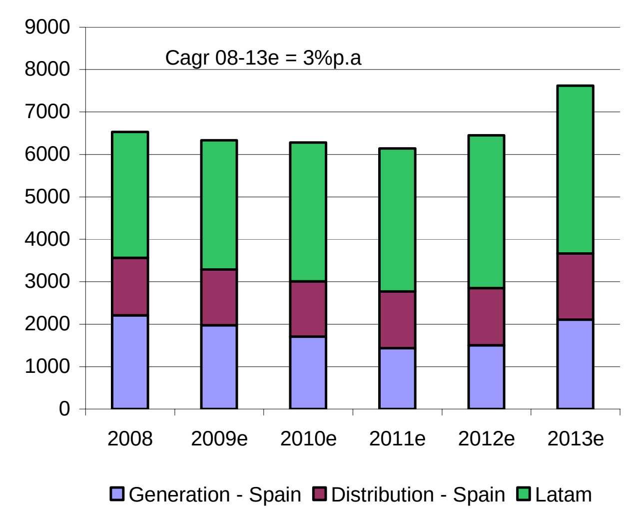
Endesa: change in estimates, 2009-12e

(€mn)	2008	2009e	2010e	2011e	2012e
EBITDA					
Old	6,895	6,493	6,352	6,351	6,699
New	6,867	6,556	6,281	6,140	6,452
Change (%)	-0.4	1.0	-1.1	-3.3	-3.7
Net Profit					
Old	7,169	2,220	1,980	1,863	2,026
New	7,141	2,226	2,022	1,757	1,885
Change (%)	-0.4	0.3	2.1	-5.7	-7.0
Net debt					
Old	(13.8)	(13.1)	(12.4)	(12.3)	(12.0)
New	(13.8)	(13.1)	(12.3)	(12.5)	(12.3)
Change (%)	0.0	-0.1	-0.3	1.1	2.5

Source: Morgan Stanley Research estimates

Exhibit 23

Modest growth adjusting for disposals



e = Morgan Stanley Research estimates Source: Company data, Morgan Stanley Research

Exhibit 24

De-gearing to suggest a stronger dividend policy

Debt (€mn)	2009e	2010e	2011e	2012e	2013e
Initial debt on 1/1	(13,790)	(13,124)	(12,336)	(12,452)	(12,280)
Operative cash flow	2,965	3,886	3,753	3,801	4,361
Capex	(3,001)	(2,448)	(2,362)	(2,575)	(2,590)
Dividend	(7,191)	(1,849)	(1,508)	(1,054)	(1,131)
Securitisation of tariff deficit	5000				
Disposal of Renewables	2890				
Disposal of network		1200			
Others	2	(1)	0	0	0
Cash generated	666	789	(116)	172	641
Final debt on 31/12	(13,124)	(12,336)	(12,452)	(12,280)	(11,639)
Net Debt/EBITDA	2.0	2.0	2.0	1.9	1.5

Source: Morgan Stanley Research estimates

On the back of our new scenario analysis, we are reducing our target from €23.6 to €21.3, mainly after trimming the valuation of the group's Spanish generation assets. While in the short term the impact on EBITDA is limited by forward sales, in the long run we believe Endesa's thermal assets will run at a lower load factor given the structural overcapacity within Spain. This affects the valuation.

We value Endesa at €22.6bn, or €21.3 per share, using a WACC of 6.8% for generation and 5.94% for the regulated business. We use Enersis's share price to value the group's Latin America activities. Our new price target values the group's capacity installed in Spain at €723/MW, down from €824/MW. This is well below replacement cost (-20%) and reflects the aging of Endesa's coal power stations and the reduced competitiveness of CCGTs today's oversupplied market. Our new price target implies multiple of 7.2x 2010 EV/EBITDA.

Risks to price target

Commodity risk. In our base case, we use the prices for oil, CO_2 and the US dollar implied by the forward curve for the medium term (2009-12). We also assume a stable $1.35/€1 exchange rate. On pool prices in Spain, we see €3/MWh spark spreads for CCGTs in 2009-12 reflecting the overcapacity in Spain. We assume spark spreads recover in 2013 and CCGT prices reflect new-entrant costs.

Endesa's valuation is highly sensitive to these assumptions. We flex the key value drivers to show the impact of changing commodity prices, Spanish demand growth and electricity prices (see Exhibit 26). An increase in commodity prices would be positive for Endesa, given its exposure to hydro and nuclear generation. This is true for many companies, though, and we believe that, relative to the market, Endesa is one of the least exposed, also in light of its relatively low gearing.

Exhibit 25

Endesa: cut in value of generation assets

Sum-of-the-Parts (€mn)	New	Old
Generation & supply – Spain	15,822	18,043
Distribution – Spain	11,539	11,401
Domestic Business	27,361	29,444
Latin America	20,035	20,568
Other international NPV	0	
Total EV	47,396	50,012
Other Investments / financials	1,840	1,727
Regulatory receivables end 2009	335	335
Net Debt 2009	-13,124	-13,139
Minorities	-9,939	-10,032
Provisions	-3,957	-3,957
Special dividend	0	0
Equity Value (€mn)	22,551	24,946
Shares (mn)	1,059	1,059
Implied value per share (€)	21.3	23.6

Source: Morgan Stanley Research estimates

Exhibit 26

Endesa: key valuation sensitivities

Sensitivities	Impact on EBITDA (€mn)	Impact on Valuation (€ per share)
+ US$1/bbl long-term oil price	10	0.06
+ €1/MWh Spanish generation prices	40	0.26
10% weakness of US$	-90	-0.65

Source: Morgan Stanley Research estimates

Delivery of synergies with ENEL. We see some risk in the planned delivery of synergies with ENEL, although we have factored the company's own targets into our estimates.

M&A risk. ENEL controls Endesa with its 92% stake. In its 2009-13 business plan, ENEL indicated that it is focusing on disposing of some €10bn of assets, which may include some Endesa activities. Endesa has already signed an agreement with Acciona for the sale of its renewables business and, by law, must sell its high-voltage grid assets to REE by 2010. The perimeter of these assets has yet to be clearly indicated.

Minority shareholder risk. ENEL's 92% ownership of Endesa may, we think, represent a risk/opportunity for minority shareholders. To effect synergies and create opportunities, ENEL may decide to reorganise the group by selling/buying assets to/from Endesa. It could also enter into an intercompany loan agreement with Endesa to finance its large debt. Note, however, that ENEL's management has not announced any such plans.

Exhibit 27

Endesa: Profit & loss account, 2008-13e

(€mn)	2008	2009	2010	2011	2012	2013
EBITDA						
Electricity Generation – Spain	2430	2073	1702	1438	1501	2108
Electricity Distribution – Spain	1472	1437	1310	1328	1349	1559
Endesa Europe/other	0	0	0	0	0	0
Electricity Generation – LatAm	1620	1670	1846	1941	2155	2494
Electricity Distribution – LatAm	1314	1344	1392	1403	1417	1432
Other LatAm adjustments	31	31	31	31	31	31
EBITDA	6867	6556	6281	6140	6452	7624
EBITDA margin (%)	36.5	39.6	37.1	35.5	35.8	39.2
Depreciation	1661	1627	1603	1614	1639	1670
EBIT	5206	4929	4679	4526	4813	5954
Net Financials	1009	1023	843	806	812	803
EMI	83	0	0	0	0	0
Extraordinary	4884	1222	700	0	0	0
EBT	9164	5128	4536	3720	4002	5151
Income taxes	1082	1099	991	893	960	1236
Net Income (pre minorities)	8082	4029	3545	2827	3041	3914
Minority interests	941	948	1033	1070	1157	1293
Net Income	7141	3081	2512	1757	1885	2622

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 28

Endesa: Balance sheet, 2008-13e

(€mn)	2008	2009	2010	2011	2012	2013
Tangible Assets	31575	32949	33294	34042	34978	35897
Intangible Assets	1183	1183	1183	1183	1183	1183
Prepaid Tax Assets	2158	2158	2158	2158	2158	2158
LT Financial Investments	6088	1088	1088	1088	1088	1088
Goodwill	2053	2053	2053	2053	2053	2053
Tot. Fixed Assets	**43057**	**39431**	**39776**	**40524**	**41460**	**42379**
Receivables	6628	6350	6260	6255	6368	6714
Inventories	1092	885	952	1004	1046	1071
ST. Financial Investments	4814	4814	4814	4814	4814	4814
Cash & Equivalents	357	357	357	357	357	357
Assets for sale	1668	0	0	0	0	0
Current Assets	**14559**	**12406**	**12383**	**12430**	**12585**	**12956**
Total Assets	**57616**	**51837**	**52159**	**52954**	**54045**	**55335**
Share Capital	2647	2647	2647	2647	2647	2647
Ret. Earnings	9982	5875	6538	6788	7618	9109
Other Reserves	4453	4453	4453	4453	4453	4453
Stockholders' Equity	17082	12974	13638	13888	14718	16209
Minority Interests	3682	3966	4276	4597	4944	5332
Deferred Revenues	3398	3398	3398	3398	3398	3398
Pension Provisions	808	808	808	808	808	808
Risk Provisions	3149	3149	3149	3149	3149	3149
LT Debt	17580	16914	16126	16242	16070	15429
LT Liabilities	30618	30237	29758	30195	30370	30117
ST. Debt	1381	1381	1381	1381	1381	1381
Op. Payables	2818	1828	1965	2073	2158	2210
of which Trade Payables	2818	1828	1965	2073	2158	2210
Tot. Other liabilities	5717	5417	5417	5417	5417	5417
Other current liabilities	5717	5417	5417	5417	5417	5417
Current Liabilities	9916	8626	8763	8871	8957	9009
Stockholders' Equity + Liabilities	57616	51837	52159	52954	54045	55335

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 29

Endesa: Cash flow statement, 2008-13e

€mn	2008	2009e	2010e	2011e	2012e	2013e
EBIT	5,206	4,929	4,679	4,526	4,813	5,954
Depreciation	1,661	1,627	1,603	1,614	1,639	1,670
Change in working capital	1,415	(805)	161	61	(69)	(319)
Minorities	(2,400)	(663)	(723)	(749)	(810)	(905)
Financial	(926)	(1,023)	(843)	(806)	(812)	(803)
Tax	(1,082)	(1,099)	(991)	(893)	(960)	(1,236)
Cash Flow from Operations	3,874	2,965	3,886	3,753	3,801	4,361
Maintenance capex	(1,415)	(1,385)	(1,349)	(1,393)	(1,526)	(1,927)
Sustainable Free cash flow	2,458	1,581	2,538	2,360	2,275	2,434
Development capex	(2,197)	(1,616)	(1,099)	(969)	(1,049)	(663)
Free cash flow	262	(35)	1,439	1,391	1,226	1,772
Dividends	(1,621)	(7,191)	(1,849)	(1,508)	(1,054)	(1,131)
Assets disposal/others	9,997	7,892	1,199	0	0	0
Net cash flow	8,637	666	789	(116)	172	641

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Iberdrola: Pressure on Short-term EBITDA to Rekindle Debt Concerns – Downgrade to EW

What's Changed

Rating	**Overweight to Equal-weight**
Price Target	**€8.10 to €7.30**

Downgrade to Equal-weight; price target cut to €7.3. Over the past three months, Iberdrola has outperformed the sector by 10.5% owing to its high-quality assets, large exposure to regulated business and general expectations of government support for the securitisation of the tariff deficit. This catalyst has now played out, in our view, and the sharp decline in demand means that the outlook is deteriorating. We are downgrading the stock to Equal-weight and, in Iberia, now prefer Endesa.

Demand decline to put pressure on EBITDA; downside risk to consensus. The sharp decline in demand in Spain and the pressure on spark spreads lead us to cut our EBITDA estimates for 2009-13 by 2.8% and our EPS estimates by 8.7%. On our new estimates we see some 8% downside risk to consensus earnings forecasts.

Multiples justified, but debt and regulatory risk call for caution. On our new estimates, the stock (excluding renewables) trades at a 25% EV/EBITDA premium to the integrated players. This is justified, in our view, by the stronger than average long-term growth trend of the group. Nevertheless, we believe that the sharp decline in demand in Spain and intensifying pressure on EBITDA from a weak Spanish generation market are weighing on the net debt/EBITDA ratio (3.9x in 2010, we estimate). This, we feel, calls for caution.

Key Ratios and Statistics

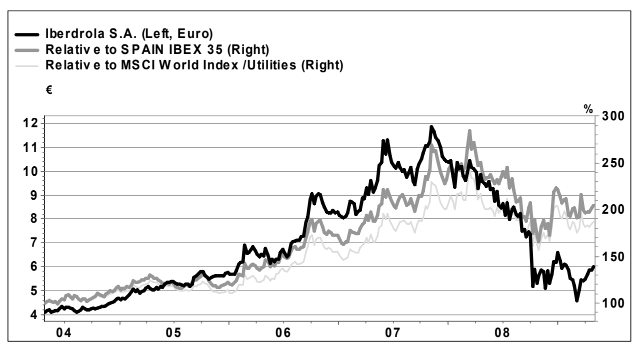
Reuters: IBE.MC Bloomberg: IBE SM
Utilities / Spain

Price target	**€7.30**
Shr price, close (May 6, 2009)	€6.09
52-Week Range	€9.84-4.36
Mkt cap, cur (mn)	€30,412
Net debt (12/09e) (mn)	€32,052
EV (12/09e) (mn)	€59,815

Fiscal Year ending	**12/08**	**12/09e**	**12/10e**	**12/11e**
ModelWare EPS (€)	**0.50**	**0.50**	**0.54**	**0.57**
Prior ModelWare EPS (€)	**0.49**	**0.54**	**0.57**	**0.63**
P/E	**13.2**	**12.1**	**11.4**	**10.8**
Consensus EPS (€)§	**0.51**	**0.54**	**0.58**	**0.61**
Div yld (%)	5.0	5.0	5.3	5.6
Div per shr (€)	0.33	0.30	0.32	0.34
EBITDA (€mn)	6,415	7,128	7,563	8,002
Prior EBITDA (€mn)	6,438	7,309	7,698	8,306
EBITDA, consensus (€mn)	6,457	7,287	7,745	8,396
EV/EBITDA	9.2	8.4	8.1	8.0

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).
§ = Consensus data is provided by FactSet Estimates.
e = Morgan Stanley Research estimates

Price Performance

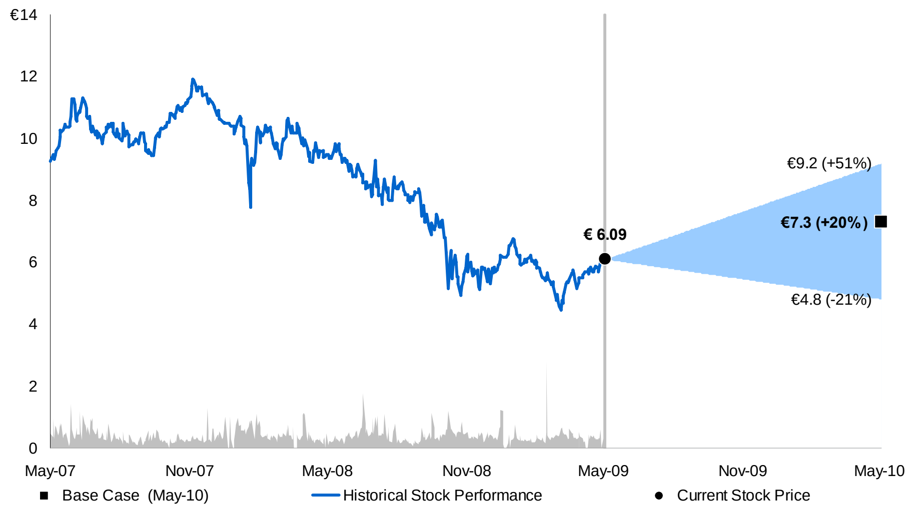


Source: FactSet Research Systems Inc

Company Description
Iberdrola is the largest Spanish utility by market cap, managing 24GW of capacity in Spain and controlling 30% of the Spanish distribution market. It is also the world leader in renewable generation (via IBR), with large presence in the UK (Scottish Power) and US (Energy East). Iberdrola also operates in Mexico and Brazil.

Risk-Reward Snapshot: Iberdrola (IBE.MC, Equal-weight, PT €7.3)

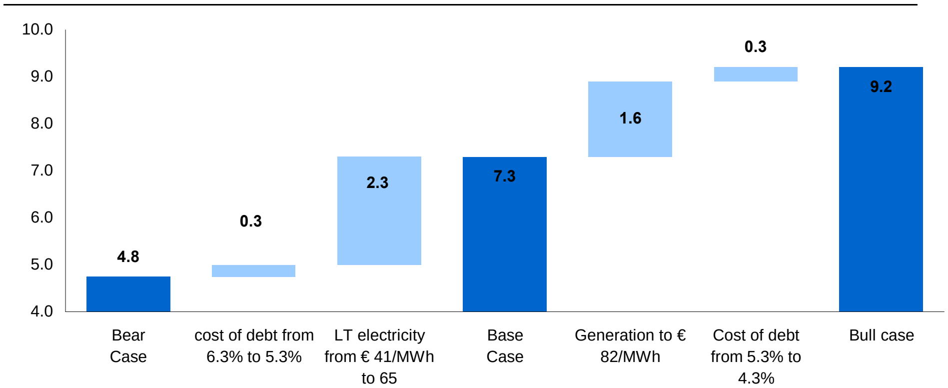
Low commodities and prolonged recession scenario are in the price



Source: FactSet (historical share price data), Morgan Stanley Research estimates

Bull Case €9.2	11.3x 2009e EV/EBITDA	**Strong outlook for commodities and reduction in cost of debt.** Higher long-term generation prices (€82/MWh from 2013) and a reduction in the cost of debt from 5.3% to 4.3% would boost valuation by 26%, implying 51% upside potential.
Base Case €7.3	9.6x 2010e EV/EBITDA	**Selective capex approach and control of debt.** Management is focusing on optimising the group's asset portfolio, selecting investment projects on the back of new market conditions and generating synergies with recently acquired companies (SPW and EE), as well as cost cutting.
Bear Case €4.8	8.0x 2010e EV/EBITDA	**Weak electricity prices and higher cost of debt.** €41/MWh long-term electricity prices and average cost of debt at 6.3% would allow some 21% downside risk to share price, one of the lowest among Spanish Integrated players. This confirms our view that Iberdrola's business model is highly resilient to weak market conditions.

Spanish demand growth and synergies are Iberdrola's key drivers



Source: Morgan Stanley Research estimates

Why Equal-weight?

- Owing to its large exposure to nuclear, wind and hydro, Iberdrola's generation volumes will be only modestly affected (+0.5% in 2009e) by the substantial slowdown in demand that we are witnessing in Spain (-6.4% expected for 2009e). Also, its large exposure to regulated (42% of EBITDA in 2009) and renewables assets (20%) should protect the group from volatility in the generation market.
- However, Iberdrola remains one of the most geared companies in our coverage universe. Even a modest reduction of EBITDA could represent a risk for the group. On our new estimates, and assuming the securitisation of the tariff deficit, net debt/EBITDA should remain in the region of 4x in 2009-12. This could expose the group to volatility in the financial market and reduce flexibility.
- **Attractive P/E valuation.** Excluding IBR, Iberdrola trades at 8.4x 2010e P/E, a 7.2% discount to the sector. We believe this discount is unjustified in light of the low returns we expect in Spain in 2010.
- The share price discounts a long-term generation price of €54/MWh, below our long-term assumption of €65/MWh.

Catalysts

- Rate case at Energy East should start in September 2009.

Iberdrola: Weak Spanish Market Adds Pressure to Financial Structure

Iberdrola has outperformed its vertically integrated peers by 10% over the past three months thanks to its high-quality assets and exposure to regulated names. Nevertheless, worsening conditions in the Spanish generation market and higher net debt due to an increase in working capital are a concern to us. We still see 20% upside potential to the stock, but prefer Endesa (25% potential upside). We are cutting our EBITDA estimates by 2.8% on average (2009-13) and our EPS by 8.7%. We reduce our target price to €7.3.

- **Slowdown in Spanish demand; 8.7% cut in earnings.** We lower our EPS estimates to reflect lower demand in Spain. This only has a modest effect on Iberdrola generation (-3-4% compared with our previous estimate), but puts pressure on spreads in Spain, affecting the group's overall generation profitability.
- **New estimates show downside risk to consensus earnings.** We see some 3-4% downside risk to the group consensus EBITDA and some 8% risk on EPS.
- **Concerns again on financial structure.** We now expect that the lower EBITDA growth in the short term will prevent the group net debt/EBITDA from falling. We assume the level remains around 4x until 2012 at least. While we think the nature of IBE's business should enable the company to manage this ratio, IBE's net debt/EBITDA ratio is among the highest in Europe.
- **Valuation cut by 9.9% to €7.3; better value elsewhere.** We are cutting our price target, reducing the value of Iberdrola's Spanish generation assets, and marking to market the stake in IBR. Following the 1Q09 results, we are also increasing our net debt estimates for 2009 to €28.4bn. We assume that the group tariff deficit (€2.4bn at the end of 2008) will be securitised by year-end.

Stronger than expected decline in Spanish demand leads to 8.7% cut in our IBE EPS estimates

We are revising our Iberdrola model to reflect the bleak demand outlook we anticipate for Spain. Following weak data this year (-9.4% adjusted for weather and calendar), we now expect electricity demand in Spain to decline by 6.5% on a full-year basis, down from our previous 3% expected decline. This scenario, combined with an increase in capacity installed (CCGTs under construction and new renewables development), is likely to trigger an oversupply scenario that we think will depress Spanish spark spreads in the medium to long term. As a consequence we are also revising our electricity price assumptions, as we now expect Spanish clean spark spreads to remain in the region of €3/MWh, in line with the last two-year average. (See analysis on page 4.)

On the back of this scenario, we are revising our EBITDA and EPS estimates for Iberdrola.

Our new estimates are now below consensus. In particular we see some 3.8% downside risk on EBITDA and 10% on EPS. The major difference in between our forecasts and consensus lies in the contribution of the Spanish generation assets to group EBITDA. We also believe that estimates on group net debt could prove too optimistic, given Iberdrola's large increase in working capital in 1Q.

Exhibit 30

Lower volumes and lower prices

NEW Assumptions	2009	2010	2011	2012	2013
Oil price($/bbl)	50.0	62.7	67.9	70.7	84.0
US$/€	1.32	1.32	1.32	1.32	1.35
Spanish Pool Price €/MWh	41.8	47.6	50.2	51.4	65.0
Demand growth Spain (%)	-6.5	-1.0	1.0	1.0	1.0
CCGT load factor (%)	31	24	22	22	22
OLD Assumptions					
Oil price($/bbl)	53.0	63.0	67.0	70.0	84.0
US$/€	1.3	1.3	1.3	1.3	1.4
Spanish Pool Price €/MWh	45.6	51.1	53.0	54.5	65.0
Demand growth Spain (%)	-3.0	0.4	1.5	1.5	1.5
CCGT load factor (%)	32	27	25	25	32

Source: Morgan Stanley Research estimates

Exhibit 31

Iberdrola: change in estimates, 2009-12e

(€mn)	2009e	2010e	2011e	2012e
EBITDA				
Old	7,309	7,698	8,306	8,961
New	7,128	7,563	8,002	8,749
Change	(2.5)	(1.8)	(3.7)	(2.4)
Net profit				
Old	2,698	2,867	3,151	3,512
New	2,517	2,677	2,823	3,212
Change	(6.7)	(6.6)	(10.4)	(8.5)
Net debt				
Old	26267	26115	27747	28640
New	28555	29373	31302	32512

Source: Morgan Stanley Research estimates

Exhibit 32
Iberdrola: downside risk to consensus EBITDA …

Iberdrola EBITDA (€mn)	2009e	2010e	2011e
Consensus	7287	7745	8396
MS	7128	7563	8002
Change (%)	-2.2	-2.3	-4.7

Source: IBES, Morgan Stanley Research estimates

Exhibit 33
… and net income, 2009-11e

Iberdrola net income (€mn)	2009e	2010e	2011e
Consensus	2716	2901	3099
MS	2517	2677	2823
Change (%)	-7.3	-7.7	-8.9

Source: IBES, Morgan Stanley Research estimates

On the back of our lower EBITDA expectations, we see the net debt /EBITDA ratio remaining around 4x. This is one of the highest levels among the integrated utilities, even though we think it should be sustainable given the long-term growth potential of the group and the limited maintenance capex needed. Refinancing needs are limited in 2009. The group's €3.2bn of refinancing is largely covered by €9.1bn of liquidity. Nevertheless, the high debt may create earnings volatility, also given that 55% of the group's debt is at floating rates.

Exhibit 34
Net debt ratio to remain close to 4x EBITDA

(€mn)	2009	2010	2011	2012
Initial debt	(28,363)	(28,555)	(29,373)	(31,302)
Refinancing	(3,184)	(2,947)	(3,636)	(4,205)
New debt	(192)	(818)	(1,929)	(1,210)
Total financial needs	(3,376)	(3,765)	(5,565)	(5,415)
Final debt	(28,555)	(29,373)	(31,302)	(32,512)
Net debt/EBITDA	**4.01**	**3.88**	**3.91**	**3.72**

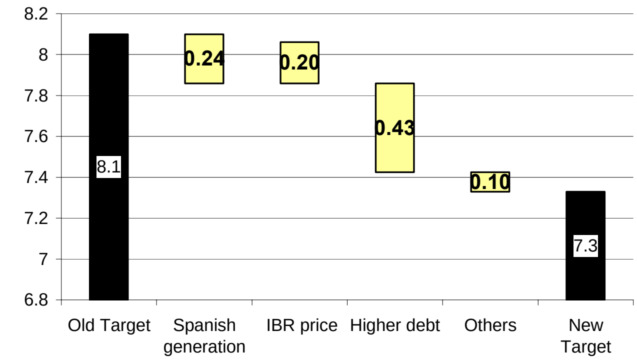
Source: Morgan Stanley Research estimates

SOP: price target reduced to €7.3 per share

We cut our target price to reflect the lower value of generation assets in Spain, to mark to market the group's stakes in IBR, EDP and Games, and to reflect higher 2009 year-end net debt following the substantial expansion in working capital in 1Q, which we expect will be only partially recovered over the next few quarters.

We derive our €7.3 price target from a DCF-based sum-of-the-parts valuation of each of the company's divisions and using market prices for the listed participations (Iberdrola Renovables, EDP and Gamesa). This includes electricity production, supply and distribution in Spain, electricity production supply and distribution in the UK and regulated activities in the US. We use an average WACC of 7.2% and a 1.5% long-term growth rate.

Exhibit 35
Cut in target price to €7.3



Source: Morgan Stanley Research estimates

Exhibit
SOP: lower value from generation assets

(€mn)	New	Old	Change
Generation & Supply – Spain	16,760	17,964	-1,204
Infrastructure – Spain	8,694	8,956	-262
Electricity – Spain	25,454	26,919	-1,465
		0	
UK – gen & supply	6,036	7,114	-1,078
Infrastructure – UK	4,099	4,099	0
Electricity – UK	10,135	11,213	-1,078
Renewable	18,858	16,834	2,023
Mexico	2,258	2,692	-434
Brazil	2,952	3,160	-208
LatAm	5,210	5,852	-642
Energy East	5,725	5,653	72
Real Estate and others	2,313	2,880	-567
Other Investments	4,533	4,859	-326
		0	
Total EV	72,228	74,210	-1,983
Net Debt 09e	28,555	26,267	2,288
Cash Provisions 09e	4,336	4,943	-607
Minorities	2,737	2,534	203
Equity Value (€mn)	36,600	40,465	-3,866
		0	
Implied value per share (€)	7.3	8.1	

Source: Morgan Stanley Research estimates

We value the Spanish generation and supply business at €16.8 billion (WACC 6.8%, growth of 1.5%) or €780/KW for capacity installed in 2009. This division includes the generation capacity operating under an 'ordinary regime'. The quality of Iberdrola's generation assets is very high with 65% of the production coming from nuclear and hydro stations.

We value the Spanish infrastructure business at €8.7 billion (WACC 6.3% and long-term growth of 1.5%). Our valuation implies a 2010 EBITDA multiple of 9.4. Allowed revenues are updated with a price cap formula and are partly linked to growth in demand and inflation. In 2009 revenues should increase by 8%, according to the Spanish regulator.

We value the UK EV of Scottish Power at €10.1 bn or 6.5x 2010 EV/EBITDA. The UK business represents 14.0% of Iberdrola's enterprise value, on our estimates. We value the group's regulated assets at RAB and use a DCF to value the UK generation and supply businesses.

Iberdrola also operates in Latin America (mainly Mexico and Brazil). We value the LatAm assets at €5.2bn (5.9x 2010 EV/EBITDA). In Mexico, the company operates 5GW of CCGT capacity, which we value at €2.3bn or €456/KW, in line with reconstruction costs. The group entered into a tolling agreement for 25 years. This assumes fuel costs as a pass-through and assures a fixed spark spread. In Brazil, the company mainly distributes electricity in the north east. We value the group's distribution activities at €2.9bn, or 5.8x 2010 EV/EBITDA. Our valuation and estimates reflect a recent rate cut that occurred at Iberdrola concessions.

We value Energy East at €5.7bn. This implies 8.3x 2010 EV/EBITDA. In our model we assume that the rate case expected at the end of 2009 for the New York activities will result in a reduction of the allowed return to 10.5%.

We value Iberdrola Renovables EV at €18.8bn using the current market price. Our valuation adds back to the group market cap some €5 bn of debt/tax equity expected by the end of 2009.

We value Iberdrola's other assets at an EV of €6.8bn. This includes the engineering and real-estate business (valued at 7x 2009 EV/EBITDA) and the group's other financial assets, including participations in EDP, Gamesa and Iberdrola's own shares. We value these at current market prices. We also include the potential tax benefit that the group will enjoy thanks to the tax-deductible depreciation of goodwill following the SPW acquisition (€0.5bn). This benefit is not guaranteed in the long term, so we consider in our SOP only 50% of the potential NPV.

Risks to price target

We still see regulatory risk in Spain. The relevant reduction in demand is heightening the regulatory risk, as the tariff deficit is increasing despite the higher access tariff, given lower volumes. We expect the 2009 tariff deficit to reach €3.7bn and only a relevant increase in access tariffs could balance the situation. In this context we see a risk of unexpected measures that could affect the profitability of Spanish companies. Although the government has offered to guarantee these credits, allowing the securitisation of the tariff deficit, we believe the underlying problem remains, with very limited visibility on when and how real liberalisation of the market will be implemented.

Project execution. Iberdrola's strong growth is linked to the development of projects (renewables, infrastructure and other generation assets). The delivery of the company's capex in 2007-15 is worth €0.6 per share, according to our calculations.

M&A speculation creates volatility. Iberdrola is one of the few stocks in European utilities with an unlocked shareholder structure. In the past, this has triggered speculation that IBE could become involved in M&A activity. For example, according to an unconfirmed article in *Expansion* on April 7, 2009, ACS, which holds a 12.6% stake in Iberdrola, wishes to increase this stake to 20%.

Exhibit 36

Iberdrola: Profit & loss Account, 2008-13e

(€mn)	2008	2009	2010	2011	2012	2013
Total Revenues	20801	22606	24059	25311	27028	28682
EBITDA (%)		19				
Spain Gen & Supply	1517	1537	1592	1622	1665	2130
Distrib – Spain	996	936	924	912	1106	1133
Supply – Spain	0	0	0	0	0	0
Gen & Supply UK	755	765	714	708	747	560
Regulated UK	748	788	807	826	845	865
Energy US	92	682	690	715	722	728
Renewables	1186	1339	1715	2062	2490	3028
International	891	844	879	924	952	969
Others	364	327	330	323	314	305
Integration adjustments & other	-134	-90	-88	-90	-92	-94
EBITDA	6415	7128	7563	8002	8749	9624
EBITDA margin (%)	30.8	31.5	31.4	31.6	32.4	33.6
Depreciation	1902	2044	2174	2336	2464	2605
Provision	249	250	250	250	250	250
EBIT	4264	4834	5139	5416	6035	6770
Net Financial Expenses	1026	1278	1350	1409	1476	1521
EMI	73	97	102	107	112	118
Equity in Profit / Loss	80	97	102	107	112	118
Extraordinary Result	555	0	0	0	0	0
EBT	3867	3653	3891	4114	4671	5367
Income taxes	895	1023	1089	1152	1308	1503
Minority interests	108	113	124	139	151	194
Net Income	2864	2517	2677	2823	3212	3670

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 37

Iberdrola: Balance sheet, 2008-13e

(€mn)	2008	2009e	2010e	2011e	2012e	2013e
Tangible assets	43,481	46,090	48,324	51,879	54,695	57,407
Investments/intangibles	28,584	25,969	25,719	25,469	25,219	24,969
Fixed assets	72,065	72,059	74,043	77,348	79,914	82,376
Other current assets	9,236	9,154	9,631	9,992	10,478	10,835
Total assets	81,301	81,213	83,674	87,341	90,392	93,212
Current liabilities	(19,370)	(17,467)	(17,409)	(17,231)	(17,081)	(16,732)
Net Financial Debt	(28,363)	(28,555)	(29,373)	(31,302)	(32,512)	(33,556)
Provisions	(7,351)	(7,855)	(8,360)	(9,008)	(9,564)	(10,025)
Net assets	26,217	27,337	28,532	29,800	31,236	32,899
Shareholders' equity	(24,280)	(25,287)	(26,358)	(27,487)	(28,772)	(30,240)
Minority interest	(2,344)	(2,457)	(2,581)	(2,720)	(2,871)	(3,065)
Total liabilities	81,708	81,620	84,081	87,748	90,799	93,618

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 38

Iberdrola: Cash flow statement, 2008-13e

(€mn)	2008e	2009e	2010e	2011e	2012e	2013e
EBIT	4,264	4,834	5,139	5,416	6,035	6,770
Depreciation	2,151	2,294	2,424	2,586	2,714	2,855
Change in working capital	8,571	(1,317)	(29)	108	(80)	(244)
Interest – equity	(946)	(1,181)	(1,248)	(1,302)	(1,364)	(1,403)
Tax	(895)	(1,023)	(1,089)	(1,152)	(1,308)	(1,503)
Cash Flow from Operations	13,145	3,607	5,197	5,657	5,997	6,474
Capex & investments net	(6,581)	(4,633)	(4,409)	(5,892)	(5,280)	(5,316)
Free cash flow	6,564	(1,026)	788	(235)	717	1,158
Dividends	(1,658)	(1,510)	(1,606)	(1,694)	(1,927)	(2,202)
Financing	(7,808)	2,345	0	0	0	0
Net cash flow	(2,902)	(192)	(818)	(1,929)	(1,210)	(1,044)

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

EDP: Lower Exposure to Cycle Is in the Price – Stay EW

What's Changed

Price Target	**€3.20 to €3.30**

Change in short-term scenario, modest change in estimates. We are revising our estimates to reflect a stronger than expected reduction in demand in Iberia and pressure in the Spanish and Portuguese pool. Given the long-term nature of the company's contracts, the impact of deteriorating scenario is modest on EDP's EBITDA (-1.9% on average in 2009-11) and net profit (-6.4%). Marking EDPR to market leads us to raise our price target slightly, to € 3.3 per share.

Limited impact from cycle ... Excluding the renewables business, EDP trades at a premium to the integrated utilities on 2010 EV/EBITDA (6.8x, we estimate, versus 6.1x) and at a discount in terms of P/E (7.9x versus sector average of 9.0x). We believe that the discount on P/E is justified, as, excluding renewables, EDP would have a net debt/EBITDA ratio equal to 4.6x – one of the highest in the industry.

... but limited long-term growth. We estimate that EDP's long-term contracts imply a price of €67/MWh in 2010, above the spot price and our long-term price assumptions. Therefore, our long-term growth expectation for the group's generation division is slightly negative (-1% in our estimates).

Better value elsewhere. We believe that, in the short term, EDP will not be penalised by the worsening demand/supply balance in Iberia, as it has limited earnings exposure; however, the structural overcapacity may increase concerns over terminal value of Iberian assets. EDP's equity story is built on the assumption that, in the long term, European generation prices will converge. While we buy into this theme, we believe that the widening price gap between Iberia and central Europe, and the absence of any real signs of recovery, could undermine this confidence. The value of EDP's market-exposed generation assets represents c.70% of its equity, in line with other integrated companies (62% at Iberdrola and 80% at Endesa). The gloomy outlook for generators in Spain and Portugal is likely, we think, to weigh on EDP's shares while a potential market recovery is already in the price. Upside potential is therefore limited, in our opinion.

Key Ratios and Statistics

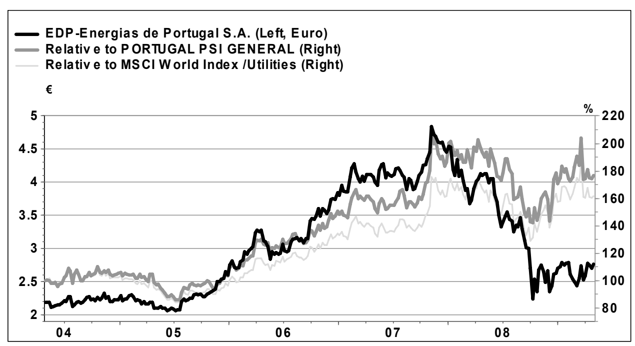
Reuters: EDP.LS Bloomberg: EDP PL
Utilities / Portugal

Price target	**€3.30**
Shr price, close (May 6, 2009)	€2.82
52-Week Range	€4.22-2.06
Mkt cap, curr (mn)	€10,311
Net debt (12/09e) (mn)	€14,144
EV (12/09e) (mn)	€26,175

Fiscal Year ending	**12/08**	**12/09e**	**12/10e**	**12/11e**
ModelWare EPS (€)	**0.30**	**0.23**	**0.23**	**0.23**
Prior ModelWare EPS (€)	**-**	**0.23**	**0.25**	**0.25**
P/E	**9.0**	**12.1**	**12.3**	**12.1**
Consensus EPS (€)§	**0.25**	**0.24**	**0.26**	**0.27**
Div yld (%)	5.2	5.5	6.0	6.3
Div per shr (€)	0.14	0.16	0.17	0.18
EBITDA (€mn)	3,123	3,155	3,293	3,459
Prior EBITDA (€mn)	3,123	3,199	3,355	3,525
EBITDA, consensus (€mn)	3,132	3,277	3,476	3,724
EV/EBITDA	8.2	8.3	8.3	8.1

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).
§ = Consensus data is provided by FactSet Estimates.
e = Morgan Stanley Research estimates

Price Performance

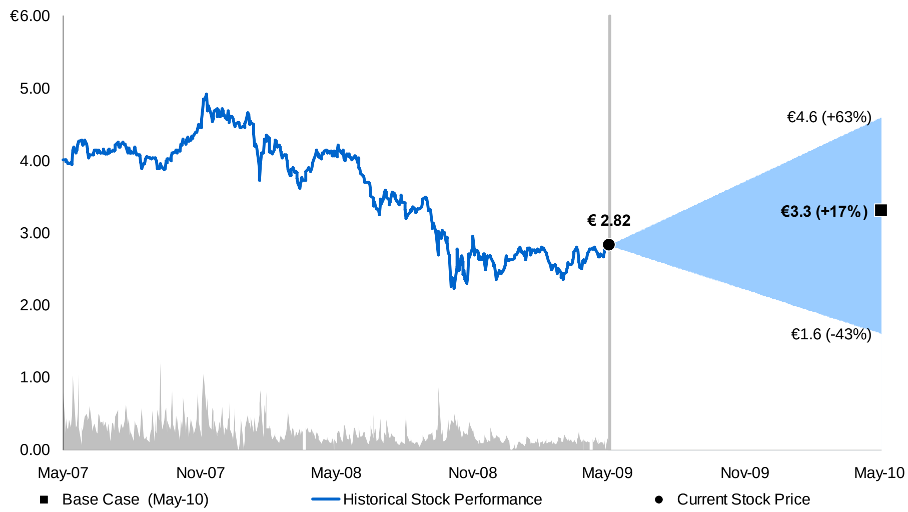


Source: FactSet Research Systems Inc

Company Description
EDP is the largest Portuguese utility, with 9.7GW of capacity installed and 100% share of the distribution market. EDP is also present in Spain, with 2GW of capacity and a 6% stake in distribution. In 2007 EDP founded EDP Renovaveis, the world fourth-largest renewables energy producer. Via its control of EDB (66% stake), EDP is also a large player in Brazil.

Risk-Reward Snapshot: EDP (EDP.LS, Equal-weight, PT €3.3

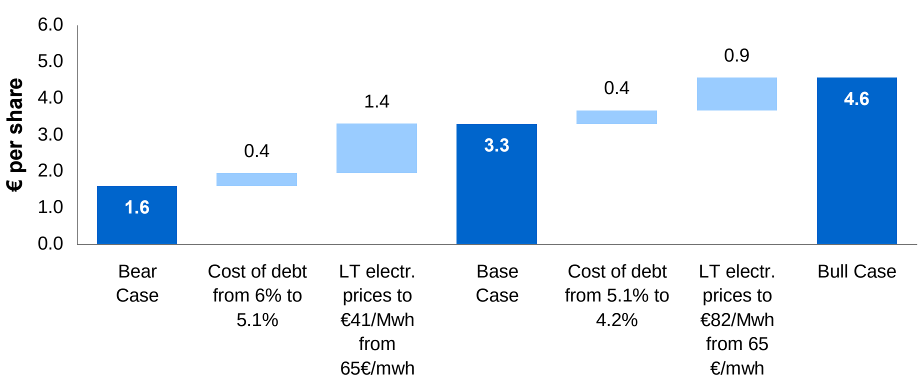
Current share price reflects long-term electricity prices of €57.5/MWh



Source: FactSet (historical share price data), Morgan Stanley Research estimates

Bull Case €4.6	10.7 x 2009e EV/EBITDA	**Higher long-term electricity prices, lower cost of debt.** We assume that EDP's cost of debt will reduce to 4.2%. We also assume long-term Portuguese electricity prices reach €82/MWh, €17/MWh above our base case scenario.
Base Case €3.3	8.8 x 2009e EV/EBITDA	**Developing renewables and controlling costs.** We assume EDP will develop some 6-7GW of wind generation by 2010 and that controllable costs will increase 100 bps below inflation. In our base case we assume a long-term power price of €65/MWh.
Bear Case €1.6	6.8 x 2009e EV/EBITDA	**Poor commodity outlook.** EDP's valuation is sensitive to long-term electricity prices. Assuming a long-term price of €41/MWh and cost of debt at 6% we believe EDP offers some downside risk.

Valuation: exposed to long-term electricity prices and cost of debt



Source: Morgan Stanley Research estimates

Why Equal-weight?

- EDP has outperformed the sector by 17% since the beginning of the year, reflecting the market's appreciation of the group's defensive short-term earnings and consistent strategy. The stock still offers 17% potential upside to our price target, in line with the sector average.
- However, on our estimates, EDP's free market generation (including Portuguese generation after the expiry of the contracts) represents 31% of the group EV and 72% of group equity value. EDP is therefore largely exposed to long-term generation and the current share price discounts long-term electricity prices of €57.5/MWh, above the sector average.
- We see some 12.2% downside risk to the management business plan that, in our view, does not yet discount the slow down in the economy and the possible pressure on generation profitability. We see downside risk to management targets in 2010 and we believe this might disappoint investors.

Key Value Drivers

- Long-term oil and electricity prices.
- Cost of debt.
- Capex implementation is a relevant value driver, in our view.
- We see substantial room for restructuring, mainly in EDP's Portuguese activities. Every €15 million of cost savings would boost our price target by €¢5 or 1%.

EDP: Limited Impact from Short-term Recession as Long as Long-term Outlook Is Unchanged

Modest reduction in EBITDA and EPS

We are fine-tuning our EBTDA and EPS estimates to reflect the following:

- **Lower than expected demand in Spain and Portugal.** This has an impact on EDP's production volumes. We expect total production to decline by 7% in 2009 despite the availability of the Soto plant for the entire year. This compare with our previous 2% estimated decline.
- **Lower electricity price in the pool.** We now assume that electricity prices in Spain and Portugal reach €41.5/MWh in 2009 (5% below our previous estimate) and remain below €50/MWh until 2011. Lower prices in the short term will have a modest impact on EBITDA, given the long-term contracts signed and that 80% of the group's liberalised electricity has been sold forward for this year.
- **Modest increase in tax rate** from 20% to 21.5% to reflect new company guidance.

These changes lead to a modest reduction in group EBITDA (-1.9% on average) and net profit (-6.4% on average for 2009-12).

Exhibit 39

EDP: change in estimates, 2009-12e

(€mn)	2009e	2010e	2011e	2012e
EBITDA				
Old estimates	3,199	3,355	3,525	3,767
New estimates	3,154	3,293	3,461	3,679
Change (%)	-1.4	-1.8	-1.8	-2.3
Net profit				
Old estimates	857	905	930	1,066
New estimates	856	839	853	961
Change (%)	-0.2	-7.3	-8.3	-9.8

Source: Morgan Stanley Research estimates

Valuation still solid in absolute terms, target price increased to €3.3

The small changes in estimates lead us to adjust our price target too. While the decline in demand in Spain and Portugal may affect volumes produced in the long term, affecting the value of EDP's generation assets, in the shorter term, the strong performance of EDPR and EDB supports our sum of the parts – hence the slight increase in target price.

Exhibit 40

SOP: Marking to market EDPR and EDB more than offsets the lower value of generation assets

	€mn	Comment
Generation – Portugal	9,231	€951/ MW
Generation – Spain	1,202	€372 / MW
Renewable	10,284	
Distribution – Portugal	4,330	
Distribution – Spain	720	
Iberian Gas	1,831	
Brazil	2,849	
Group EV	30,448	
Other	314	
Total EV	30,763	
Net Debt 2009e	(13871)	
Provisions / PTC	(3022)	
Minorities	(1660)	
Equity Value (€mn)	12,210	
Shares (mn)	3,657	
Implied value per share (€)	3.3	

Source: Morgan Stanley Research estimates

We derive our €3.3 price target for EDP from a DCF-based sum-of-the-parts valuation of each of the company's divisions. This includes electricity production, supply and distribution in Portugal and Spain, gas supply in the Iberian Peninsula and others. We use an average WACC of 6.65% and a 2% long-term growth rate. To value the group's Brazilian activities and the renewables division, we use EDB's and EDPR's current share prices. In our model we roll forward the valuation to the end of 2009.

Risks to price target

In addition to commodity risk and cost of debt risk, we see risk relating to the regulatory framework in Spain and Portugal and the execution of projects. These risks are already reflected in our bull/bear analysis on the previous page.

Project execution. EDP's strong growth is linked to the development of projects (renewables, hydro generation plants in Portugal and other generation assets in Spain). While most of the projects have been approved, we see some risk that specific projects or some of the capex plan could be delayed or cancelled, given EDP's relatively high gearing.

M&A risk. Over the last few months EDP has focused on small acquisitions, mainly in the renewables energy space. We see both up- and downside risk here, depending on the choice of potential target and the price paid.

Relative valuation in line; we prefer Endesa in Iberia. As already mentioned, EDP is widely perceived as a defensive name, with good earnings visibility given that 40-50% of group volumes (but 80% of EBITDA) is sold via long-term contracts not exposed to electricity market prices. While this protects earnings to some extent, we believe it does not protect the valuation, as the value of the assets exposed to the Iberian generation market (value of liberalised generation and residual value of contracted assets after the expiry of long-term contracts) represents c.70% of the group's equity value, in line with the other European integrated names.

So EDP's risk profile is similar to that of Endesa and Iberdrola, even if earnings are more stable. In this context, we prefer Endesa, which trades at a discount to EDP and IBE and presents a lower risk profile. Also, in terms of dividend yield, we believe EDP is the least attractive option in Iberia. This is amplified by the fact that our estimates of EDP discount an ARPU of €60/MWh, well above both Iberdrola and Endesa.

Exhibit 41

EDP valuation is sensitive to electricity market movements

Equity exposure to generation	
EDP (%)	70.6
Iberdrola (%)	62.0
Endesa (%)	80.5

Source: Company data, Morgan Stanley Research

Exhibit 42

Shares are trading in line with Iberian utilities

EV/EBITDA	2009e	2010e	2011e	2012e
EDP (excl. renewables)	6.7	6.8	6.8	6.8
Endesa	5.8	6.0	6.2	5.9
ENEL	6.2	6.2	6.6	6.3
Gas Natural	8.0	7.6	7.1	6.7
IBE (excl. renewables)	8.0	7.9	7.8	7.4
Iberian average	6.9	6.9	6.9	6.6

Source: Morgan Stanley Research estimates

Exhibit 43

EDP: Profit and loss account, 2008-13e

(€mn)	2008	2009e	2010e	2011e	2012e	2013e
Total Revenues	13,634	10,379	10,873	11,282	12,504	12,890
EBITDA	3,155	3,189	3,328	3,496	3,714	4,015
EBITDA margin (%)	23.1	30.7	30.6	31.0	29.7	31.2
	1,208	1,143	1,038	969	1,038	1,151
Generation and Supply	359.1	264	179	148	220	472
Long-term contracted generation	849.2	879	860	820	819	679
Renewable energy	437.9	612	805	1000	1237	1360
Regulated networks	755.2	642	641	655	680	737
Gas	206.7	198	204	210	216	216
Brazil	562.3	593	640	662	543	551
Other & Adjustments	-16	0	0	0	0	0
EBITDA	3,154.9	3,189	3,328	3,496	3,714	4,015
Depreciation	1,191	1,276	1,352	1,430	1,509	1,565
Provisions	32	34	35	37	39	41
EBIT	1,931	1,879	1,941	2,028	2,166	2,409
Financial revenues	0	0	0	0	0	0
Financial charges	(721)	(639)	(689)	(737)	(786)	(823)
Net financial charges	(721)	(639)	(689)	(737)	(786)	(823)
Associates	35	30	31	31	32	32
Extraordinary components	252	0	0	0	0	0
Pre-tax results	1,496	1,271	1,282	1,323	1,412	1,618
Income taxes	(284)	(261)	(263)	(271)	(290)	(333)
Deferred taxes	0	0	0	0	0	0
Minority interests	(121)	(155)	(180)	(198)	(161)	(180)
Net profit	1,092	856	839	853	961	1,106
ModelWare EPS (€)	0.30	0.23	0.23	0.23	0.26	0.30

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 44

EDP: Balance sheet, 2008-13e

(€mn)	2008	2009e	2010e	2011e	2012e	2013e
Current assets	6,881	5,734	5,857	5,798	6,045	6,314
Current liabilities	(9,416)	(9,547)	(9,716)	(9,855)	(9,974)	(10,023)
Net working capital	(2,535)	(3,813)	(3,859)	(4,056)	(3,929)	(3,709)
Fixed assets	28,032	29,719	31,048	32,349	33,587	34,067
Long term liabilities	(3,060)	(3,067)	(3,037)	(3,007)	(2,977)	(2,947)
Net invested capital	22,437	22,839	24,152	25,286	26,681	27,411
Financial assets	(797)	(797)	(797)	(797)	(797)	(797)
Financial liabilities	14,687	14,668	15,618	16,422	17,428	17,647
Net financial debt	13,890	13,871	14,821	15,625	16,631	16,850
Share capital	3,657	3,657	3,657	3,657	3,657	3,657
Reserves	1,616	2,197	2,485	2,703	2,903	3,179
Minorities	2,182	2,259	2,349	2,449	2,529	2,619
Net profit	1,092	856	839	853	961	1,106
Shareholders' funds	8,547	8,968	9,330	9,661	10,050	10,560
Total	22,437	22,839	24,152	25,286	26,681	27,411

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 45

EDP: Cash flow statement, 2008-13e

(€mn)	2008	2009e	2010e	2011e	2012e	2013e
EBIT	1,931	1,879	1,941	2,028	2,166	2,409
Depreciation & Provisions	1,224	1,310	1,388	1,468	1,548	1,606
Change in working capital	(1,089)	1,278	46	197	(127)	(220)
Deferred tax/PTC	(70)	(27)	(65)	(67)	(69)	(71)
Cash flow from operations	1,996	4,440	3,309	3,626	3,518	3,724
Associates	35	30	31	31	32	32
Tax	(284)	(261)	(263)	(271)	(290)	(333)
Capex	(3,618)	(2,962)	(2,681)	(2,732)	(2,747)	(2,045)
Free cash flow	(1,871)	1,247	396	654	513	1,379
Dividends	(392)	(589)	(657)	(721)	(733)	(775)
Interest	(721)	(639)	(689)	(737)	(786)	(823)
Financing	1,300	30	30	30	30	30
Net cash flow	(1,685)	49	(920)	(773)	(976)	(189)

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

ENEL: Rights Issue Reduces Risk, but Recession May Hit Earnings

ENEL's management has announced a business plan that should reinforce the company's financial structure. Thanks to its €8bn rights issue, disposals for €10bn and a substantial cut in dividend, we estimate that net debt should reach €47.1bn in 2010 (€45bn is management target) – a sustainable level just above 3.2x EBITDA. Given the agreement for the sale of Endesa's renewables assets, offers for the electricity and gas network in Italy, and the law enforcing the sale of Endesa's Balearic and Canary Island transmission assets, there is a good degree of visibility on the sale of some €6.6bn of assets. This limits the execution and timing risk, in our view. We believe that ENEL's debt is now under control.

ENEL is not immune to the recession, however. Given the weak demand we are expecting in Italy and Spain in 2009-10, we now see prices remaining in the region of €55-60/MWh in Italy and €41-48/MWh in Spain over the period 2009-11. This scenario is likely, we think, to challenge management's targeted €16bn of EBITDA in 2010 (we forecast €14.6bn). We also believe that ENEL's EBITDA and earnings should reach a trough in 2011 when favourable forward sales expire.

Still downside risk to consensus earnings, and premium to multiples unjustified. Despite the improvement in the group's financial situation, given the falling demand and higher than expected D&A (€5.3bn in 2009, we estimate, above €4.8bn consensus expectations), we foresee a cut in consensus estimates. This would affect DPS, given ENEL's 60% payout policy. The stock trades at a premium to the industry, with a P/E increasing to 13.8x in 2011 after the rights issue, on our estimates. We remain Underweight.

Operational and financial leverage leads to large downside risk on our bear case. Assuming long-term electricity prices at €42/MWh would imply c.90% potential downside to the shares, on our analysis. This reflects the large downside risk to Italian generation profitability (the highest prices in Europe) and the company's high gearing.

Key Ratios and Statistics

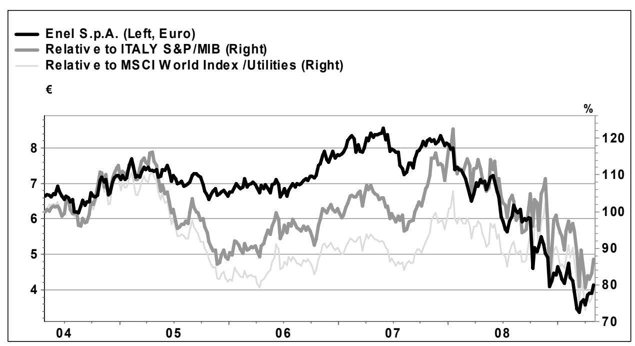
Reuters: ENEI.MI Bloomberg: ENEL IM ADR: EN.N
Utilities / Italy

Price target	**€4.00**
Shr price, close (May 6, 2009)	€4.28
52-Week Range	€7.27-3.23
Mkt cap, curr (mn)	€26,476
Net debt (12/09e) (mn)	€60,145
EV (12/09e) (mn)	€93,099

Fiscal Year ending	**12/08**	**12/09e**	**12/10e**	**12/11e**
ModelWare net inc (€mn)	5,293	3,673	3,041	2,515
Prior net income (€mn)*	5,062	3,813	2,910	2,924
Net income, consensus (€mn)	5,110	3,997	3,984	3,864
P/E	**5.4**	**9.4**	**11.4**	**13.8**
Div yld (%)	10.5	6.4	5.3	4.4
EBITDA (€mn)	14,318	15,030	14,551	13,830
Prior EBITDA (€mn)	14,237	15,016	14,306	14,493
EBITDA, consensus (€mn)	14,232	14,770	15,487	15,708
EV/EBITDA	6.1	6.2	6.2	6.6

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).
*** =** GAAP or approximated based on GAAP
e = Morgan Stanley Research estimates

Price Performance



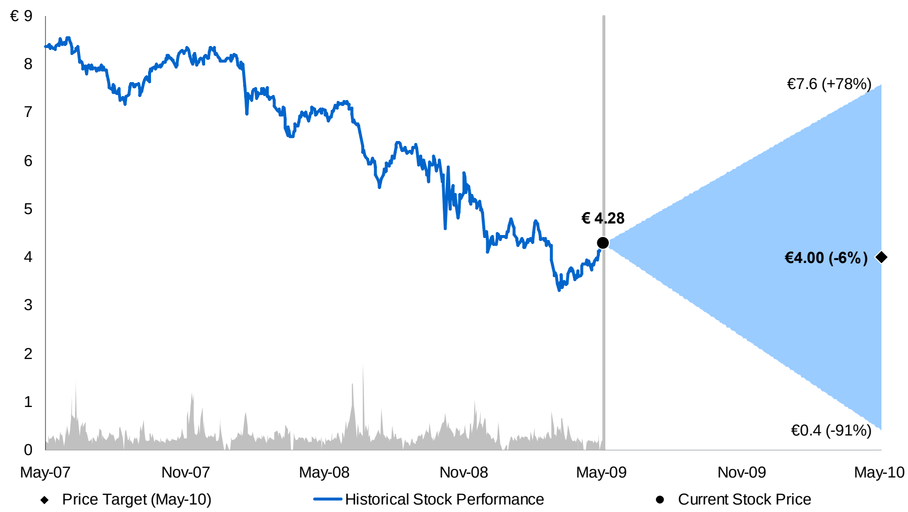
Source: FactSet Research Systems Inc

Company Description

Enel is Italy's largest electricity producer (38GW of capacity installed) and the largest distributor, controlling 86% of the Italian distribution network. It also controls 92% of Endesa, Spain's largest integrated electricity payer. The group is a relevant player in Slovakia, controlling 66% of the country's monopolist SE, and Russia, where it controls OGK5. The company is growing in the area of renewable energy via ENEL Green Power, which manages 4.8GW of renewable generation. Following recent acquisitions, the group is focusing on reducing debt and has announced a €10bn disposal programme.

Risk-Reward Snapshot: ENEL (ENEI.MI, Underweight, PT €4.0)

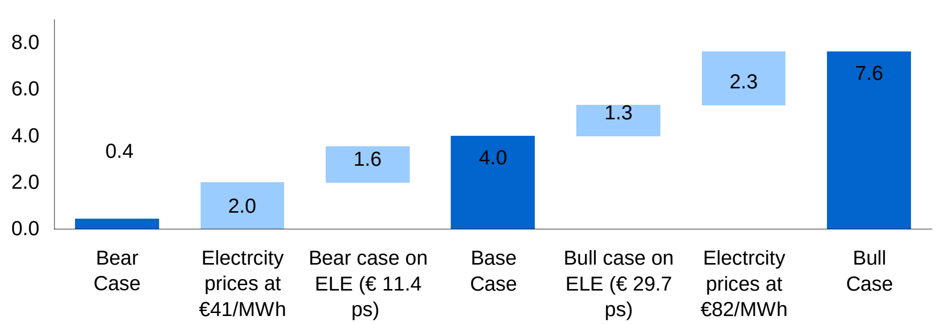
High leverage makes for a wide risk-reward range



Source: FactSet (historical share price data), Morgan Stanley Research estimates

Price Target €4.0		Derived from our base-case scenario.
Bull Case €7.6	7.8x 2010e EV/EBITDA	**Strong commodity scenario to boost valuation.** In our bull case we assume electricity prices average €82/MWh and Europe long-term spark spreads rise to €18/MWh.
Base Case €4.0	6.1x 2010e EV/EBITDA	**Oil price at $84/bbl and new entrant already discounted in the share price.** In our base case we assume oil, CO_2 and electricity prices for Italy and Spain based on the current forward oil price curve. Long term, we assume electricity prices of €65/MWh.
Bear Case €0.4	4.8x 2010e EV/EBITDA	**Tough low commodities environment.** Long-term oil price remains c. 50$/bbl and electricity prices €41/MWh. Our analysis shows that ENEL's valuation could be put seriously at risk by an adverse commodity market dynamic.

Lower commodities could put ENEL's value under pressure



Source: Morgan Stanley Research estimates

Why Underweight?

- **Debt risk profile is reducing ...** Following the announcement of an €8bn rights issue, cut in the dividend and €10bn of disposals, we believe ENEL's net debt should fall gradually to 3.2x EBITDA in 2010 and below 3x in 2013. We see the execution risk as limited on some €6.6bn of assets (ELAT, gas network, Endesa's renewables and Endesa's network), given the advanced status of the disposal process.
- **…but recession may put pressure on earnings and dividend.** We expect ENEL's EBITDA to reduce gradually from 2008 (€16.6bn EBITDA, assuming 100% consolidation of Endesa). This trend should reflect the reduction in electricity prices and the decline in demand in both Italy and Spain.
- **We see downside risk to management's 2010 targets.** Lower earnings should also lead to lower DPS, given the new dividend policy.

Key Value Drivers

- We expect Spanish pool prices to remain under pressure over the next three to four years.
- Cost of debt is a major element of ENEL's valuation. We assume the long-term cost of debt reaches 5.3%.

Where we could be wrong

- Small changes in market conditions could substantially change ENEL's coverage ratios.
- Every 50 bps decline in the cost of debt would reduce ENEL's financial charges by some €300 million, we estimate, boosting EPS by 8-10%.

ENEL: Rights Issue, Disposals and Cut in Dividend to Normalise Debt

We are updating our model to reflect:

- lower demand in electricity in Italy and Spain;
- lower spark spreads in both countries;
- the implementation of the recent rights issue announced by the company; and
- implementation of the sale of 40% of the group's renewables division, as anticipated by the management.

These changes mainly affect group EBITDA from 2011, when the effect of forward sales expires. Given the fairly high gearing, net profit estimates amplify the reduction in EBITDA and come down by 9% (2009-11).

Exhibit 46

ENEL: Change in estimates, 2009-12e

(€mn)	2009e	2010e	2011e	2012e
EBITDA				
Old estimates	15,016	14,412	14,491	15,105
New estimates	15,030	14,551	13,830	14,293
Change (%)	0.1	1.0	-4.6	-5.4
Net Profit				
Old estimates	3,746	2,901	2,813	2,931
New estimates	3,673	3,049	2,530	2,439
Change (%)	-1.9	5.1	-10.1	-16.8

Source: Morgan Stanley Research estimates

Exhibit 47

Net debt should decline to sustainable levels after rights issue

Net debt evolution (€mn)	2008	2009e	2010e	2011e	2012e	2013e
Initial net debt	(57,541)	(49,967)	(51,723)	(46,631)	(46,924)	(46,428)
Cash flow from operations	10,024	8,937	8,184	7,799	7,729	8,367
Maintenance capex	(3,277)	(4,609)	(4,603)	(4,512)	(4,769)	(4,780)
Development capex	(3,225)	(2,907)	(1,682)	(1,756)	(951)	(622)
Free cash flow	3,522	1,422	1,899	1,531	2,009	2,965
Dividends	(3,026)	(2,600)	(2,204)	(1,830)	(1,518)	(1,463)
EON transaction	8,400					
OGK5	(814)					
Muntenia	(395)					
Network disposal	0	2,300				
Hydro	(70)		500			
Endesa's renewables		2,640				
Acciona Put option		(15,713)				
Securitisation of the tariff deficit		1,685				
Endesa's Island network			1,200			
Sale of minorities in renewables			2,873			
Maritza			314			
sale of ELE international			500			
Rights issue		8,000				
Russian gas reserves		500				
Others	(43)	(122)	9	5	0	0
Acq/disp & extraordinaries	7,078	(710)	5,396	5	0	0
Net cash flow	7,574	(1,890)	5,091	(293)	496	1,508
Final net debt	(49,967)	(51,723)	(46,631)	(46,924)	(46,428)	(44,920)
Net debt/EBITDA	3.5	3.4	3.2	3.4	3.2	2.9

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 48

ENEL SOP

	EV (€mn)	Methodology	2009e	2010e
Market	2,047	DCF	5.6	5.4
Enel Produzione	17,099	DCF implies €507/KW	5.4	6.7
Enel Distribuzione	22,621	DCF, 5.5% premium on 2009e RAB	6.8	6.7
Endesa	47,396		8.3	7.5
Slovenske 100%	6,702	€1105kw for hydro/nuke and coal	8.1	14.0
Renewables	7,183	€1270/MW	8.0	8.1
OGK5 (100%)	1,740	€200/MW	11.4	7.0
Banat & Drabogea	675	6 X 2009e EBITDA	5.4	6.0
Muntenia	240	6 X 2009e EBITDA	6.0	5.8
Enterprise Value	105,703		7.0	7.3
Holding and Financials	2,206	Participation		
Provisions	(8,422)	Provision for Risks		
Minorities	(14,838)	Slovenske, Banat, Drabogea, Muntenia, Enersis, OGK5 and Endesa		
Net Debt 2009e	(51,723)			
Rights issue	(8,000)			
Core Equity Value	24,927			
Implied value per share (€)	4.0			

Source: Morgan Stanley Research

Our model is based on a DCF for the major business areas. We use a WACC of 6.8% for Generation and 6.1% for Distribution. In Generation, we assume long-term growth of 2%, in line with inflation. Our long-term commodity scenario assumes that Italian electricity prices reach €65/MWh and Italian spark spreads reach €14/MWh. Our valuation of the regulated assets (electricity distribution network) is based on a DCF using RAB as a terminal value. We use our €21.3 price target for Endesa and a DCF or per MW multiples to value the group's international assets.

Risks to price target

In addition to commodity prices, our valuation would be affected by synergies, project execution and M&A.

Delivery of synergies with Endesa. We see some risk in the delivery of synergies with Endesa, considering the limited overlap of the two groups' activities.

M&A risk. ENEL has announced its intention to dispose of part of its gas network and a stake in its renewables company, Green Power. Management recently indicated its interest in UNF renewables assets.

Project feasibility. We assume ENEL will build an additional 1.3GW of renewables capacity over five years (2009-13) and develop a nuclear power station in Slovakia by 2015. We also assume that Endesa will develop 2GW of capacity in Latin America. These projects carry some execution risk.

Regulatory risk. We see some regulatory risk in Spain. Nevertheless, the recent reduction in commodity prices may ease the pressure on the regulator to intervene heavily.

Upside risks to our view

Being quite highly geared, small changes in market conditions could substantially change ENEL's coverage ratios. As noted above, changes could involve commodities and electricity prices. Also, the cost of debt represents a relevant variable that could change the scenario. We assume that the cost of debt increases to 5.6% over the next three years, given our expectation that the duration of the debt will be extended. This is subject to future debt market conditions, and we cannot rule out improved terms. Every 50 bps decline in the cost of debt would reduce ENEL's financial charges by some €300 million, we estimate, boosting EPS by 6-7%.

Morgan Stanley Bank International Limited (Milan branch), an affiliate of Morgan Stanley, is acting as financial advisor to Enel SpA in connection with the proposed sale of a majority stake in Enel Rete Gas SpA.
This report was prepared solely upon information generally available to the public. No representation is made that it is accurate and complete. This report is not a recommendation or an offer to buy or sell the securities mentioned. Please refer to the notes at the end of this report.

Exhibit 49

ENEL: Profit & Loss account, 2008-13e

(€mn)	2008	2009e	2010e	2011e	2012e	2013e
Total Revenues	61,184	57,555	56,293	56,293	56,522	58,848
EBITDA	14,318	15,030	14,551	13,830	14,293	15,681
EBITDA margin (%)	23.4	26.1	25.8	24.6	25.3	26.6
Market	576	367	382	457	358	182
Generation & energy management	3,113	3,256	2,576	1,727	1,799	1,787
Infrastructure & Networks	3,656	3,495	3,353	3,407	3,316	3,300
ENDESA-Iberia	4,628	5,706	6,331	6,190	6,502	7,674
Renewables	1,188	903	886	1,013	1,163	1,358
International	1,044	1,223	943	955	1,071	1,294
Holding & services	112	80	80	82	83	85
Depreciation	4,777	5,373	5,388	5,464	5,576	5,669
EBIT	9,541	9,657	9,162	8,366	8,717	10,013
Net financial charges	(3,210)	(2,521)	(2,516)	(2,395)	(2,626)	(2,570)
Associates	288.0		0	0	0	0
Pre tax Results	6,619	7,135	6,646	5,971	6,090	7,443
Income taxes	(585)	(2,252)	(2,108)	(1,908)	(1,948)	(2,343)
Tax rate	8.8	31.6	31.7	31.9	32.0	31.5
Third-party interests	(741)	(1,210)	(1,488)	(1,534)	(1,704)	(1,960)
Net profit	5,293	3,673	3,049	2,530	2,439	3,139

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 50

ENEL: Balance sheet, 2008-13e

(€mn)	2008	2009e	2010e	2011e	2012e	2013e
Current assets	27,095	24,493	23,737	23,709	23,681	24,392
Current liabilities	(25,743)	(23,775)	(23,100)	(23,262)	(23,329)	(23,975)
Net working capital	1,352	718	637	447	353	417
Fixed assets	91,622	105,063	102,572	103,375	103,519	103,252
Long term liabilities	(16,712)	(17,654)	(17,322)	(16,937)	(16,556)	(16,180)
Net invested capital	76,262	88,127	85,886	86,885	87,315	87,489
Financial assets	(12,699)	(12,699)	(12,699)	(12,699)	(12,699)	(12,699)
Financial liabilities	62,666	64,422	59,330	59,623	59,127	57,619
	0	0	0	0	0	0
Net financial debt	49,967	51,723	46,631	46,924	46,428	44,920
Share capital	6,186	8,075	8,082	8,089	8,096	8,103
Reserves	8,919	17,721	19,189	20,407	21,417	22,392
Minorities	5,897	6,935	8,935	8,935	8,935	8,935
Net profit	5,293	3,673	3,049	2,530	2,439	3,139
Shareholders' Funds	26,295	36,405	39,255	39,961	40,888	42,569
Total	76,262	88,127	85,886	86,885	87,315	87,489

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 51

ENEL: Cash flow statement, 2008-13e

(€mn)	2008	2009e	2010e	2011e	2012e	2013e
EBIT	9,541	9,657	9,162	8,366	8,717	10,013
Depreciation	4,777	5,373	5,388	5,464	5,576	5,669
Change in working capital	242	(109)	(254)	(195)	(286)	(440)
Minorities	(741)	(1,210)	(1,488)	(1,534)	(1,704)	(1,960)
Interest	(3,210)	(2,521)	(2,516)	(2,395)	(2,626)	(2,570)
Tax	(585)	(2,252)	(2,108)	(1,908)	(1,948)	(2,343)
Cash flow from operations	10,024	8,937	8,184	7,799	7,729	8,367
Maintenance capex	(3,277)	(4,609)	(4,603)	(4,512)	(4,769)	(4,780)
Development capex	(3,225)	(2,907)	(1,682)	(1,756)	(951)	(622)
Free cash flow	3,522	1,422	1,899	1,531	2,009	2,965
Dividends	(3,026)	(2,601)	(2,204)	(1,830)	(1,518)	(1,463)
Acquisitions and disposals	7,078	(710)	5,396	5	6	6
Net cash flow	**7,574**	**(1,890)**	**5,091**	**(293)**	**496**	**1,508**
Net debt	49,967	51,723	46,631	46,924	46,428	44,920
Net debt/EBITDA	3.5	3.4	3.2	3.4	3.2	2.9
EBITDA interest coverage	4.5	6.0	5.8	5.8	5.4	6.1
Net debt/market cap	190	199	136	137	136	131

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Gas Natural: Demand Destruction Is a Double Hit – Move UW

What's Changed	
Rating	Equal-weight to Underweight
Price Target	€18.31 to €12.10

Most exposed to cycle among Iberian utilities. Thermal generation strongly exposes Gas Natural to Spain's collapse in demand. In 2009 we expect production to decline by 19% (like for like). Weak thermal generation will also affect the gas market, which we expect will decline by 12.9% in 2009, denting Gas Natural's healthy wholesale margins. The medium-term outlook remains uncertain, with a prolonged recession likely in Spain and limited visibility in Latin America, according to our economists. The stock's EV/EBITDA premium to the sector is unjustified, in our opinion, and potential announcements on implementing management's disposal plan appear to be discounted in the share price. We rate the stock Underweight with a target price of €12.10.

Balance sheet repaired – almost. We believe that Gas Natural's delivery on disposals (e.g. sale of financial assets, gas distribution and customers, generation capacity as included in the group business plan) and the securitisation of Fenosa's tariff deficit should lead to 2009 year-end net debt in the region of €17.2bn, below the €19bn expected by consensus. This, combined with free cash flow generation, should lead to a net debt/EBITDA ratio of 3.6x in 2011. But 2011 is still far away, and in the meantime some €6bn of debt is coming up for refinancing.

Key Ratios and Statistics

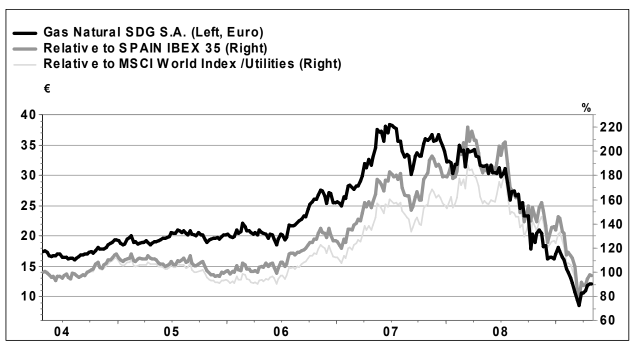
Reuters: GAS.MC Bloomberg: GAS SM
Utilities / Spain

Price target	**€12.10**
Shr price, close (May 6, 2009)	€12.58
52-Week Range	€32.43-8.39
Mkt cap, curr (mn)	€11,593
Net debt (12/09e) (mn)	€17,484
EV (12/09e) (mn)	€31,769

Fiscal Year ending	12/08	12/09e	12/10e	12/11e
ModelWare EPS (€)	**2.36**	**1.48**	**1.25**	**1.31**
P/E	**7.2**	**8.5**	**10.1**	**9.6**
Consensus EPS (€)§	**2.19**	**1.64**	**1.65**	**1.76**
Div yld (%)	7.6	5.7	5.9	6.3
Div per shr (€)	1.30	0.72	0.75	0.79
EBITDA (€mn)	2,564	3,967	4,055	4,253
Prior EBITDA (€mn)	2,504	4,555	4,436	4,644
EBITDA, consensus (€mn)	2,560	3,868	4,221	4,411
EV/EBITDA	3.9	8.0	7.6	7.1

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).
§ = Consensus data is provided by FactSet Estimates.
e = Morgan Stanley Research estimates

Price Performance

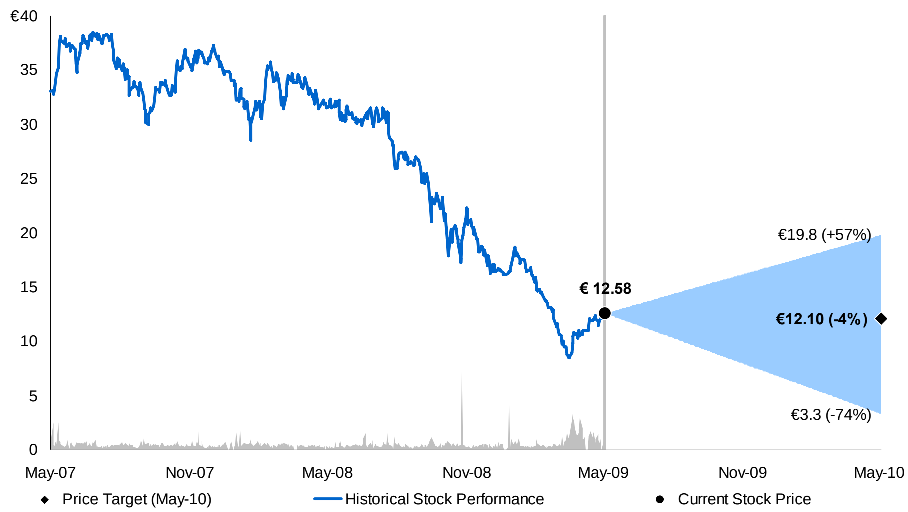


Source: FactSet Research Systems Inc

Company Description
Following the acquisition of Union Fenosa completed in April, Gas Natural is the largest gas operator in Spain (controlling 80% of gas import contracts and more than 5.4mn customers) and the third-largest player in the electricity sector (12.7GW of capacity installed and 16% market share in distribution). The group is also present in Latin America, in particular in Mexico, Puerto Rico and Colombia.

Risk-Reward Snapshot: Gas Natural (GAS.MC, Underweight, PT €12.1)

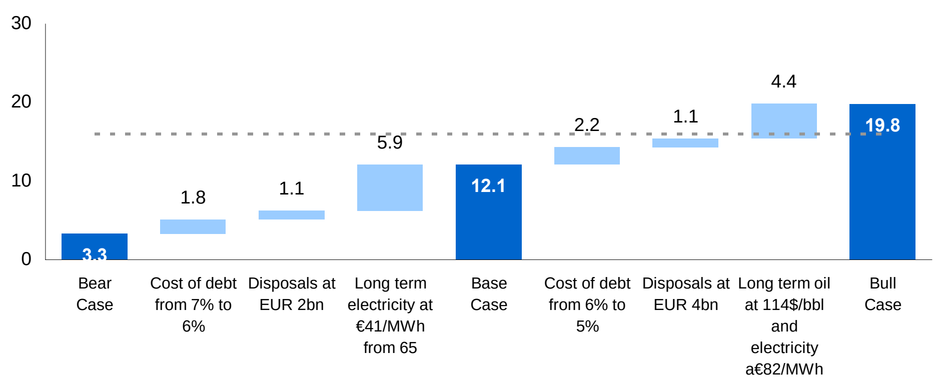
Extreme case not yet priced in; delay in recovery creates downside risk



Source: FactSet (historical share price data), Morgan Stanley Research estimates

Bull Case €19.8	9.2x 2010e EV/EBITDA	**High asset proceeds, lower cost of debt and higher commodities post 2012.** We assume that Gas Nat receives €4bn from asset disposals, cost of debt reduces to 5% and long-term electricity prices reach €85/MWh.
Base Case €12.1	7.3x 2010e EV/EBITDA	**Tough Spanish market until 2012.** We assume that Spanish spark spreads remain around €5-7/MWh until 2012 and that the group gets some €3bn from asset disposals. We also assume a long-term cost of debt in the region of 6%.
Bear Case €3.3	5.4x 2010e EV/EBITDA	**Low asset proceeds and energy prices post 2012.** We assume €2bn of asset disposals and no synergies. Low energy prices persist post 2012 with €45/MWh for electricity in Spain. We also assume cost of debt to increase to 7%.

Disposals, synergies and long-term generation margins affect valuation



Source: Morgan Stanley Research estimates

Why Underweight?

- The slowdown in the Spanish economy is hitting Gas Natural in particular, given its high gearing and exposure to thermal generation. Owing to the 6.5% decline in electricity demand that we project, we expect group production to decline by 19% in 2009, leading to a 12% reduction in EBITDA (like for like). Pressure on earnings should continue in 2010, when some hedging at UNF will expire.
- Debt is reducing and successful disposals and securitisation of the Fenosa tariff deficit could create positive news flow. Despite this we expect net debt/EBITDA to fall below 4x only in 2011, making Gas Nat one of the most geared stocks in our universe.
- Valuation is unappealing, in our view. Despite large exposure to LatAm (lower multiples), Gas Nat trades at a premium to the sector on EV/EBITDA. Adjusting for gearing, the stock is not compelling on P/E either.
- The group's risk profile remains high, with exposure to GDP trend in Spain, FX in LatAm and interest rates.

Key value drivers

- Spanish GDP and spark spreads, LatAm currencies, interest rates.

Possible upside surprise

- ENI has frequently declared its interest in acquiring UNF from Gas Natural. While this is a core asset for Gas Nat's strategy, we believe that a disposal could support the share price, reducing the debt of the group.

Catalysts

Announcement of a deal to resolve the Spanish tariff deficit.

Gas Natural: Most Cyclical Player in Iberia

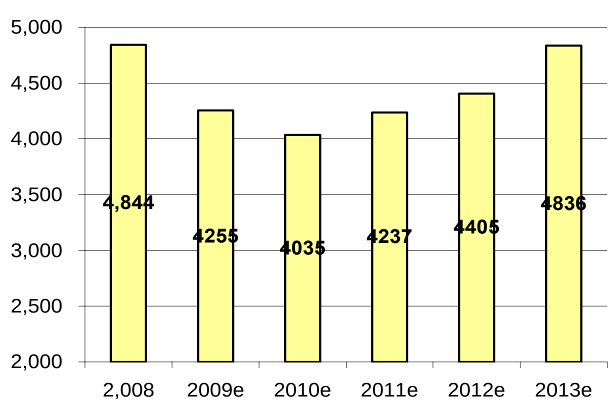
We have updated our Gas Natural model for the recent rights issue and our Oil & Gas team's new long-term forecasts. This gives us a new set of earnings estimates and a price target of €12.1 per share, which is in line with the current share price. We see less risk and more value in Endesa, Iberdrola and EDP, and hence downgrade Gas Natural to UW.

We believe that Gas Natural is the most cyclical of the Spanish integrated players, given its high gearing, the integration in E&P and the exposure to gas wholesale. With negative signals from the market in terms of electricity and gas demand (in April, electricity demand declined by 10.8%, accelerating from an already difficult 1Q09, and gas demand fell 17.3% in 1Q), we expect to see further consensus EBITDA and earnings downgrades (as much as -8.4% and -11.3%, respectively, in 2010 and 2011).

We expect group EBITDA to decline by 12% (like for like) in 2009 due to a reduction in gas supplied volumes, generation volumes and in the profitability to the group E&P activities. We expect it to reduce even further in 2010, as some of the forward sales that supported EBITDA in 2009 will expire. Reported numbers should show a growth trend, as we expect Gas Nat to consolidate Union Fenosa from April 1, 2009.

Despite the pressure on EBITDA, we believe that the financial structure of Gas Natural, while weak, is now repaired. We would therefore expect the group to maintain its BBB credit rating.

Exhibit 52
Pro forma* EBITDA under pressure until 2010e



* Assuming UNF consolidation since 1/1/2008.
e = Morgan Stanley Research estimates Source: Company data, Morgan Stanley Research

Gas Natural's net debt has been one of the major concerns for investors over the last few months. However, the group successfully closed a €3.5bn rights issue on April 3, and we believe that the de-gearing process is set to continue. In particular, we estimate that the group's net debt will reach €17.2bn at the end of 2009, some €1.8bn below consensus estimates. This should reflect:

- the cash-out from the tender offer on Union Fenosa, which took Gas Natural's stake from 14.77% to 95.22%;
- the successful securitisation of UNF's tariff deficit for €900mn – we expect a government decision on this before the summer;
- disposals for €3bn – our assumptions include the disposal of some 600,000 gas customers (and relative network) and 2GW of CCGTs, as imposed by the CNC (the Spanish competition commission). We also model the group's financial stakes (€1.058mn, of which €528mn from the sale of Cepsa, agreed in March); and
- free cash generated of €600mn in 2009 – this should reflect capex of €1.5bn and dividends paid of €0.6bn.

Exhibit 53
Gas Natural: asset disposals

Assets to be disposed	(€mn)
Financial assets	**1,058.22**
Cepsa Group*	528.5
REE 1% stake	38.8
Indra Sistemas SA	356.1
Enagas 5% stake	134.9
Peripheral assets	**554.25**
Peninsular generation	67.7
UNFERM – 100%	273.0
Zemer Energia – 50%	100.0
RED (Moldova – distribution)	78.5
Iberafrica Power (Kenya) – 72%	10.0
Associates on book	25.0
CNC disposal obligations	**1,400.00**
CCGTs	600.0
600,000 gas customers	800.0
Total	**3,012.5**

* Agreement for the sale to IPIC reached in March 2009.
Source: Company data, Morgan Stanley Research

Exhibit 54

Gas Natural: disposal and securitisation should lead to 4x net debt / EBITDA ratio in 2009e

(€mn)	2009	2010	2011	2012	2013
UNF 2008 debt	(6,743)				
Gas Nat debt	(4,912)				
Initial debt at 1/1	**(11,655)**	**(17,062)**	**(16,044)**	**(15,261)**	**(14,148)**
From 14.77% to 95.22% of UNF	(13,273)				
Rights Issue	3,500				
Securitisation of UNF tariff deficit	900				
Disposals	3,012				
Cash flow from Operation	2,807	2,783	2,879	3,049	3,402
Change working capital	(11)	446	146	(88)	(211)
Capex	(1,530)	(1,547)	(1,553)	(1,122)	(1,074)
Dividend	(582)	(663)	(689)	(727)	(804)
Others	(231)	0	0	(0)	0
Free cash flow from operations	454	1,019	783	1,113	1,314
Net cash	**(5,407)**	**1,019**	**783**	**1,113**	**1,314**
Final Debt	**(17,062)**	**(16,044)**	**(15,261)**	**(14,148)**	**(12,834)**
Net debt to EBITDA	4.3	4.0	3.6	3.2	2.7

Source: Morgan Stanley Research estimates

On our assumptions, Gas Natural's net debt/EBITDA ratio should reach 4x in 2010. This ratio is still one of the highest in the sector, but we believe that, with strong cash flow generation, the company should be able to keep its BBB credit rating.

In 2009, we assume disposals and the securitisation of the tariff deficit and that Gas Natural does not need recourse to additional debt. Nevertheless, the group's loan for the acquisition of Union Fenosa (€13.3bn at the end of 2009) should be entirely refinanced by 2013. This situation could present a risk as the overall financial structure will remain relatively fragile until the various disposals are completed.

Exhibit 55

Fenosa acquisition debt to be refinanced in 3 years

Credit Lines (€mn)	2009e	2010e	2011e	2012e	2013e
UNF acquisition debt					
1 year	2,001				
1 year + 1 year option	5,940	5,940			
3 years	2,711	2,711	2,711		
5 year	2,575	2,575	2,575	2,575	2,575
UNF Acq Debt	13,227	11,226	5,286	2,575	2,575
Other credit lines	9,796	7,015	4,347	2,347	2,347
Net debt at 31/12	17,484	16,465	15,683	14,570	13,256
Refinancing needs	(5,539)	(1,776)	6,050	9,648	8,334

Source: Morgan Stanley Research estimates

Gas Natural: intrinsic value analysis

We value Gas Natural's equity at €11.8 billion, implying a value of €12.8 per share, which we set as our new price target. Our target price is in line with the current market price. We derive our valuation using a sum-of-the parts approach, reflecting the value of the individual divisions of the combined entities.

Exhibit 56

Gas Natural: sum of the parts

Divisions	(€mn)
Spain	19,181
Generation	7,179
Gas dist.	7,584
Ele. Dist.	4,418
International	6,558
LatAm dist.	2,087
Mexico	1,790
Puerto Rico	258
Colombia / Central America / ROW	2,026
Italy	397
Up & midstream	3,966
Up & midstream	1,451
UNF Gas	2,515
Wholesale	2,247
Total enterprise value	**31,951**
less debt	17,484
less provisions	1,858
less minorities	1,422
Implied equity value	**11,187**
less rights issue to be raised	0
Shares outstanding (mn)	921.6
Implied value per share (€)	**12.1**

Source: Morgan Stanley Research estimates

Our valuation, which already includes the merger with Union Fenosa approved in April, assumes that Gas Natural:

- retains the UNF Gas and EUFER joint ventures; and
- disposes of its various equity stakes, financial interests, 1.2GW of CCGT generation and some 600,000 gas customers and their network for €3bn (Exhibit 53).

We value the generation capacity at €7.2bn or €557/KW. This is lower than our per KW valuation of Iberdrola's assets (€783/KW) and Endesa (€723/MW), which are of higher quality. Following the disposal of around 1.2GW of capacity, we expect Gas Natural to run some 12.8GW of capacity, of which 70% is thermal (coal, gas or fuel oil), implying greater exposure to these types of generation than Iberdrola (41%) or Endesa (58%). Given the pressure on demand, we expect the thermal generation load factor to be modest (30% on average in 2009-12), with a limited contribution to EBITDA.

Our DCF model (7.5% WACC) incorporates a €65/MWh long-term (post 2013) power price assumption, in line with our assumed breakeven level for a new CCGT. This implies a clean spark spread of €14.3/MWh.

Exhibit 57

Gas Natural: capacity installed

(As at year-end 2008)	(MW)
Hydro	1,820
Nuclear	589
CCGT	6,250
Coal	2,047
Gas / Oil	774
Ordinary Regime	**11,480**
Wind	1,135
Other renewables	262
Special Regime	**1,397**
Installed Capacity	**12,877**

Source: Company data, Morgan Stanley Research

We value the Spanish gas distribution at €7.85bn using a DCF based on a WACC of 6.84%. Our valuation implies a multiple of 9.1x EBITDA in 2010. We value the Spanish electricity distribution assets at €5.2bn, again using a DCF based on a WACC of 6.84%. Our valuation implies 8.5x 2010 EBITDA.

LatAm gas at €6.6 billion

We value the company's presence in Latin America (Argentina, Mexico, Colombia, Puerto Rico and Brazil) at €6.5bn, based on a DCF (12.6% WACC, 3% growth). This implies a multiple of 6x 2010 EV/EBITDA, in line with Latin American utilities.

Upstream and midstream division: €4 billion of value

This division includes the Maghreb-Europe gas pipeline, oil/gas exploration activities and 50% of UNF GAS. We value Gas Natural mid-stream assets at €1.4bn and the 50% of UNF GAS at €2.5bn.

Gas wholesale and retail division valued at €2.2 billion

Gas sales margins are the key value driver of this division. We assume they decline as competition increases. In particular, we expect the Spanish market to be oversupplied in the short term, but believe that the contract flexibility will prevent a dramatic reduction in wholesale margins. Nevertheless, margins remain under pressure, and we believe it will be hard for the company to return to the profit levels it achieved in 2008. Our DCF valuation of gas wholesale and retail (7.5% WACC, 0% growth) implies a 9.9x 2010 EV/EBITDA multiple.

Gas Natural: bull/bear cases
Given its gearing and high operational leverage, Gas Natural's valuation is extremely sensitive to changes in the commodity/market scenario. While in our bear case (long-term electricity prices at €65/MWh) Gas Natural looks fully valued, we still see substantial downside risk to our bear case (where long-term power prices remain in line with current levels).

Bull case − €19.8, 57% upside, €17/MWh spark spread
Our bull case assumes:

- higher proceeds from asset sales (€4 billion versus €3 billion);
- an environment of high energy prices post 2012 with a power price at €82/MWh and an implied spark spread of €17/MWh; and
- a cost of debt at 5% in the long term, versus 6% in our base case.

Bear case − €3.3, 74% downside, €8/MWh spark spread
Our bear case assumes:

- €2 billion of asset disposals, €1 billion less than expected;
- lower energy price environment post 2012 with long-term power prices of €45/MWh and an implied spark spread of €8/MWh; and
- a cost of debt at 7%.

Risks to price target
The following could materially affect our valuation of Gas Natural.

Difficulties in assets disposal. European utilities are trying to dispose of approximately €3bn of assets, including some 1.2GW of generation capacity and 600.000 gas customers and network. As a consequence Gas Nat may find it difficult to dispose in the short term of the €3bn of assets that management has already earmarked. This could increase pressure on the balance sheet. Also, the disposal proceeds may be materially different from what we have assumed (Exhibit 53).

Regulatory change. Large portions of Gas Natural's earnings are from regulated or semi-regulated activities in Spain and Latin America. A change in regulation in either region could affect our earnings and valuation.

Refinancing. The company has a large amount of debt to refinance between 2009 and 2011. Failure to do so, or very expensive terms, would also affect our valuation.

Exhibit 58

Gas Natural: Profit & loss account, 2008-13e

(€mn)	2008	2009e	2010e	2011e	2012e	2013e
Revenues	13,576	15,252	15,705	16,704	17,350	18,465
Group EBITDA	2,564	3,898	4,064	4,268	4,438	4,870
Gen. Spain	366	793	628	664	688	1,055
Gas dist.	886	911	866	901	936	964
Electricity Dist.	-	450	609	620	628	643
LatAm dist.	467	415	408	426	445	451
Mexico	97	150	200	204	208	212
UNF international	-	291	382	413	415	416
Up & midstream	185	215	265	270	276	274
UNF Gas	-	198	368	401	451	450
Wholesale	465	376	227	247	260	273
Other	99	100	111	122	131	133
D&A	(735)	(1,274)	(1,470)	(1,496)	(1,531)	(1,553)
Provisions	(34)	(26)	(26)	(26)	(26)	(26)
EBIT	1,795	2,598	2,568	2,746	2,880	3,292
Net Financials	(243)	(690)	(877)	(956)	(890)	(817)
EMI & goodwill amortisation	-	-	-	-	-	-
Ordinary Income	1,552	1,909	1,691	1,791	1,990	2,474
Non-Operating Income (Losses)	-	-	-	-	-	-
PBT	1,552	1,909	1,691	1,791	1,990	2,474
Income taxes	(379)	(453)	(397)	(423)	(475)	(600)
Net Income (pre minorities)	1,173	1,455	1,294	1,368	1,516	1,874
Minority interests	(115)	(142)	(140)	(146)	(152)	(154)
Net Income (post minorities)	1,058	1,313	1,155	1,222	1,363	1,719
ModelWare EPS (€)	2.36	1.42	1.25	1.33	1.48	1.87
DPS (€)	1.30	0.72	0.75	0.80	0.89	1.12

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 59

Gas Natural: Balance sheet, 2008-13e

(€mn)	2008	2009e	2010e	2011e	2012e	2013e
Tangible Assets	9,988	19,679	19,756	19,813	19,404	18,937
LT Financial Investments	2,862	132	132	132	132	132
Other Fixed Assets	1,954	16,035	16,035	16,035	16,035	16,035
Tot. Fixed Assets	14,804	35,846	35,924	35,981	35,572	35,104
Receivables	2,785	3,477	3,364	3,426	3,573	3,793
Inventories	560	718	604	651	679	721
Other Current Assets	294	739	739	739	739	739
Current Assets	3,640	4,933	4,706	4,816	4,991	5,252
Total Assets	18,444	40,779	40,630	40,797	40,563	40,357
Stockholders’ Equity	6,376	10,526	10,988	11,477	12,022	12,710
Minority Interests	345	1,729	1,869	2,015	2,167	2,321
Provisions	771	1,858	1,858	1,858	1,858	1,858
Debt	5,064	17,688	16,616	15,838	14,714	13,391
Other LT Liabilities	1,132	2,140	2,140	2,140	2,140	2,140
Current Liabilities	4,756	6,839	7,160	7,470	7,663	7,937
Stockholders’ Equity & Liabilities	18,444	40,779	40,630	40,797	40,563	40,357
Net debt / EBITDA (times)	1.9x	4.5x	4.1x	3.7x	3.3x	2.7x

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 60

Gas Natural: Cash flow statement, 2008-13e

(€mn)	2008	2009e	2010e	2011e	2012e	2013e
EBIT	1,795	2,598	2,568	2,746	2,880	3,292
D&A and change in allowances	769	1,300	1,496	1,522	1,557	1,579
Working capital change	1,254	(361)	518	160	(67)	(200)
Financial	(249)	(735)	(882)	(961)	(896)	(823)
Tax	(379)	(453)	(397)	(423)	(475)	(600)
Minorities	(115)	(142)	(140)	(146)	(152)	(154)
Operating cash flow	3,075	2,207	3,163	2,899	2,848	3,092
Maintenance capex	(618)	(715)	(721)	(727)	(776)	(819)
Free Cash Flow	2,457	1,492	2,442	2,172	2,072	2,273
Development capex	(591)	(814)	(826)	(826)	(346)	(267)
Dividends	(510)	(582)	(663)	(693)	(733)	(818)
Other	(2,452)	(7,009)	-	-	-	-
Net cash flow	(1,096)	(6,913)	953	653	992	1,188
Market cap	7,993	16,450	16,450	16,450	16,450	16,450

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Disclosure Section

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Global Stock Ratings Distribution

(as of April 30, 2009)

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	Coverage Universe		Investment Banking Clients (IBC)		
Stock Rating Category	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	668	30%	205	35%	31%
Equal-weight/Hold	1005	45%	272	46%	27%
Not-Rated/Hold	33	1%	8	1%	24%
Underweight/Sell	517	23%	108	18%	21%
Total	2,223		593		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.

Analyst Stock Ratings

Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.
Equal-weight (E). The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.
Not-Rated (NR). Currently the analyst does not have adequate conviction about the stock's total return relative to the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.
Underweight (U). The stock's total return is expected to be below the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.
Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.
In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.
Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.
Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

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Other Important Disclosures

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Industry Coverage:Utilities

Company (Ticker)	Rating (as of)	Price (05/06/2009)
Nicholas J Ashworth, CFA		
Pennon Group (PNN.L)	E (12/17/2008)	468p
Antonella Bianchessi		
A2A SpA (A2.MI)	O (07/12/2006)	€1.23
ACEA (ACE.MI)	U (01/24/2007)	€9.39
EDP (EDP.LS)	E (11/28/2008)	€2.82
ENEL (ENEI.MI)	U (10/14/2008)	€4.28
Edison (EDN.MI)	NA (12/02/2008)	€.97
Endesa (ELE.MC)	O (10/14/2008)	€17.1
Gas Natural (GAS.MC)	E (08/13/2008)	€12.58
IRIDE S.p.A. (IRD.MI)	++	€1.11
Iberdrola (IBE.MC)	O (11/28/2008)	€6.09
PPC (DEHr.AT)	E (03/26/2009)	€14.7
Snam Rete Gas (SRG.MI)	E (12/05/2008)	€3.17
Terna (TRN.MI)	++	€2.46
Union Fenosa (UNF.MC)	E (08/14/2008)	€7.52
Bobby Chada		
Centrica (CNA.L)	U (04/27/2009)	229p
Drax (DRX.L)	U (03/17/2008)	479p
International Power (IPR.L)	O (11/03/2005)	253p
National Grid plc (NG.L)	E (02/27/2008)	557p
Northumbrian Water Group (NWG.L)	E (04/03/2008)	227p
RusHydro (HYDR.RTS)	E (12/15/2008)	US$.03
Scottish & Southern (SSE.L)	O (06/05/2008)	1,074p
Severn Trent (SVT.L)	E (06/19/2008)	1,049p
United Utilities (UU.L)	U (11/26/2004)	513p
Igor Kuzmin		
Federal Grid Co of Unified Energy System (FEES.RTS)	O (04/21/2009)	US$.01
Sean Lee		
Fortum (FUM1V.HE)	E (04/27/2007)	€15.89
Morgan Stanley Research Europe		
CEZ (CEZP.PR)	NA (02/13/2009)	CZK846
E.ON (EONGn.DE)	NA (02/13/2009)	€25.81
Enagas (ENAG.MC)	NA (04/27/2009)	€12.62
RWE AG (RWEG.DE)	NA (02/13/2009)	€56.79
Red Electrica (REE.MC)	NA (04/27/2009)	€31.3
Verbund (VERB.VI)	NA (02/13/2009)	€31.7
Emmanuel Turpin		
EDF (EDF.PA)	O (01/13/2006)	€34.97
GDF SUEZ (GSZ.PA)	E (11/20/2008)	€26.53
Suez Environnement (SEVI.PA)	E (10/23/2008)	€12.54
Veolia Environnement (VIE.PA)	E (10/23/2008)	€21.65

Stock Ratings are subject to change. Please see latest research for each company.