IBR [illegible] IBR:SM

Updated Fe[illegible]ruary 18, 2009

Iberdrola Renovables (Spain)
Utility – Energy

NEUTRAL target price of EUR [illegible] (12 m[illegible]s)

2008-2010e Key Par[illegible]ters Co[illegible]ent
- N[illegible]debt/[illegible]uity ([illegible]): [illegible]-38
- [illegible]en.Ebitda/Ren[illegible]ross [illegible]argi[illegible] (%) [illegible]-76
- [illegible] Inst[illegible]ca[illegible]city [illegible]MW[illegible],302-13,600

G[illegible]owth w[illegible] c[illegible]ntinue steady but below co[illegible] guidance

■ FY2008 results showed solid improvement both in terms of margins growth and execution, with installed capacity above expectation reaching 9,302 MW. Renewable Ebitda/ Renewable Gross margin (wind + all other renewables) was 74%, compared to 71% in 2007 but still far away from [illegible]e 80% target in 2010. Net Debt/Equity stays at an hea[illegible]y 29% with cost of financing remaining at 5%.

■ While funding its assets gro[illegible] seeme[illegible]ot to [illegible]e a problem, IBR is cutting its capital [illegible]enditur[illegible] 2009 fr[illegible]n Eur 3.8 bn to Eur [illegible]n. This [illegible]s IBR [illegible] find m[illegible]e difficult to pro[illegible]ancing r[illegible]ources [illegible]a[illegible]ap[illegible]l instruments si[illegible]ar to [illegible]g-ter[illegible] lia[illegible]ties [illegible] pa[illegible]ic[illegible]ar) [illegible]r experience an[illegible]ncrease of the avg [illegible]% co[illegible] o[illegible]inanci[illegible]. Most of IBR[illegible]value is dep[illegible]nde[illegible]on [illegible]e [illegible]cess[illegible]l development o[illegible]able [illegible]d t[illegible]s o[illegible]eaching its target in term[illegible]d ca[illegible]acity ex[illegible]ns[illegible]n.

■ While we still belie[illegible] i[illegible] IBR safe profile driven by guaranteed ca[illegible] flow ([illegible]en[illegible]he strengthening of US & EU support to ren[illegible]able [illegible]erg[illegible] & favourable tariffs & incentive schemes), we [illegible]hind (respectively of 18% & 36%) company guidance of EUR 2.4 bn Ebitda & EUR 800 mn Net profit in 2010. We also believe 80% target of Renewable Ebitda/Renewable Gross Margin will be postponed from 2012e thereafter.

Co[illegible]ny Data

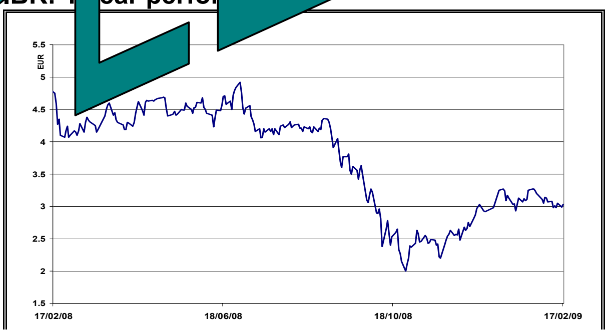
Beta	0.92
WACC %	7.3
Targe[illegible]ce [illegible] (Eur)	5.3
Potential Upside %	75
Recommandation	Neutral
Trading Data	
Shares (mn)	4,224
Mkt Cap (€ mn)	17,002
52 week H[illegible]/Low (Eur)	4.95-2.00
[illegible]aily [illegible]ding vol. (00[illegible]	11,318
Mai[illegible]har[illegible]olders: Iber[illegible]la, [illegible]A.	80%
Fre[illegible]loat	20%
[illegible]nce s[illegible]t data 2008e	
Sharehold[illegible]s equity (Eur[illegible]	11,115
Net debt ([illegible]n	3,237
Gearing	29%
P/BV	1.52
Comparables Avg.	
EV/Ebitda '09	11.2
Delta (IBR Vs.Peers)	-9.5%
P/E '09	28.3
Delta (IBR Vs. Peers)	4.2%
EPS	
EET	
2009[illegible]	0.11
2010[illegible]	0.14
[illegible]ONS[illegible]NSUS	
[illegible]09[illegible]	0.12
[illegible]10[illegible]	0.14

P&L Summary (Eur mn)	2006	2007	2008	2009e	201[illegible]
Revenues	1,537	1,581	2,030	2,477	3,1[illegible]
EBITDA	843	778	1,185	1,528	2,0[illegible]
Net Income	256	16[illegible]	390	452	57[illegible]
EPS (Eur)	0.061	0.0[illegible]	0.092	0.10[illegible]	0.1[illegible]
Net DPS (Eur)		0.0[illegible]	0.025	0.03[illegible]	0.0[illegible]

Profitability & Valuati[illegible]	4-yr hist av	[illegible]7	2008	[illegible]e	201[illegible]
EBITDA margin %	65.1	[illegible]2	58.4	6[illegible]7	63[illegible]
ROIC %	16.4	[illegible]9	3.3	[illegible]	4.0
EV/EBITDA x		[illegible]	17.1	[illegible]0	11.6
PE x		[illegible]9.6	[illegible]3.6	[illegible]7.6	29.7
Net dividend yield %	0.0	0.0	[illegible].6	1.2	1.7

Source: Company data, EET rese[illegible]ch

[illegible]BR: 1 [illegible]ear perfor[illegible]



Concerns

1. <u>2010 Ebitda and Net Profit IBR targets to be missed</u>

Renewable installed capacity increased slightly above prior company guidance in 2008 (+2,204 MW over 2007) driving the installed capacity to a record of [illegible] MW. Group revenues were up 28% YoY with Renewable Ebitda / Renewable Gross margin at 7[illegible]% in line with 9M 08 trend, [illegible]00bp better than 2007. Gross margin was positively influenced but higher avg. price per MWh (Eur 85 Vs Eur 79 in 2007 for Wind), increase in load factor and energy GWh produced. In addition, wind avg. Opex/MWh were up 28% YoY and Wind Capex/MW added increased to Eur 1.58 mn compared to Eur 0.6[illegible] mn in 2007 and Eur 1.35 mn of consensus. IBR is cutting its capital expenditure for 2009 from Eur 3.8 bn to Eur 2.[illegible] bn. Despite easing raw material cost, Wind Capex/MW added should not decrease from now going forward. Today, the Eur 18.8 bn 2008-2012 Capex plan seems to be rather optimistic. **Bearing this is mind, 2008-2012 IBR guidance for Capex is not sufficient in order to reach the targeted level of installed capacity**. We expect IBR to revise upward capital expenditure during 2009-2012 and to change the target for renewable installed capacity. The extension of PTCs in US up to the end of 2009 is positive news as well as the continuing support from US government (via the new stimulus & energy bill) and EU to renewables that will translate into stable growing tariffs for renewable energy going forward. In the meantime, we expect avg. selling price MWh in Spain to slightly ease both in 2009 and 2010, given the now weak scenario for oil price that as a consequence will drive down pool prices. Gross margin in UK will be also affected by a weak GBP/EUR. We are not confident IBR will reach the target of 80% Renewable Ebitda/Renewable Gross margin in 2010. Our forecast is 76% in 2010, improving to 78% in 2012e. In addition we expect a lower contribution from the thermal assets in the next couple of years.
Based on this, IBR will not able to reach Eur 2.4 bn of Ebitda and Eur 800 mn of Net Profit in 2010.

<u>2. Financial cost may increase</u>

Despite low gearing (29% in 2008), compared to other market players, a 50% cut of Capex this year is showing IBR may find more difficult to procure financing resources or it may pay more than avg. 5% experienced before. It's reasonable to believe financing assets via TEI (capital instruments similar to long-term liabilities) will be weaker given the tightening of the financial crisis.
In order to keep Net Debt/Equity below 50% in 2012 and support investments IBR still need to attract liquidity for ~Eur3.5 bn.

Strengths and Risks

<u>Strengths</u>: N°1 in renewable energy, less risk with gas business

■ World leader in renewable energy power generation with majority of revenues supported by Specific Regulatory Framework or by long term PPAs and with supply mainly already totally contracted.
■ High technical skills with execution above expectations.
■ Largest renewable pipeline among market players.
■ Business geographically well diversified.
■ Reducing the execution risk and gaining access to transmission capacity by holding gas and thermal assets. Gas storage business in North America has significant barriers to entry and hence the threat of competition to the existing player is low.

<u>Risks</u> : Most of IBR's value relying on its pipeline

Most of IBR's growth and value depends on the successful development of its Pipeline of which at the moment only 4% is Highly Confident that means 94% of probability of success. Delays from suppliers or difficulties in funding its investments may involve IBR planned growth will not be reached.

Main challenges within the next 2 to 4 years

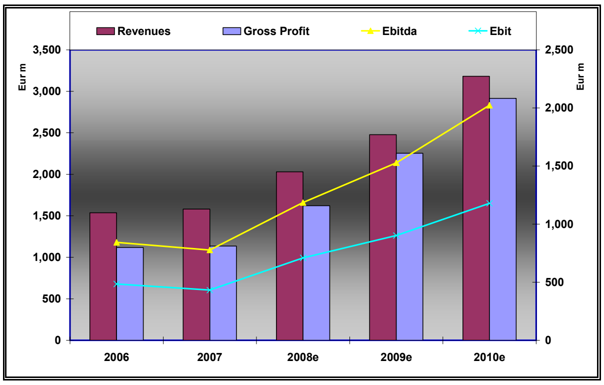
- Extend global sector leadership in renewable power with best-in-class profitability. Keeping Return on Invested Capital above cost of capital.
- Improve efficiency and asset life and ensure future growth.
- Full development of its pipeline.
- Being successful in other technology such as solar thermal, solar PV, biomass and wave energy.

EET Valuation

We confirm our NEUTRAL recommendation on IBR with a target price of EUR [illegible]35.

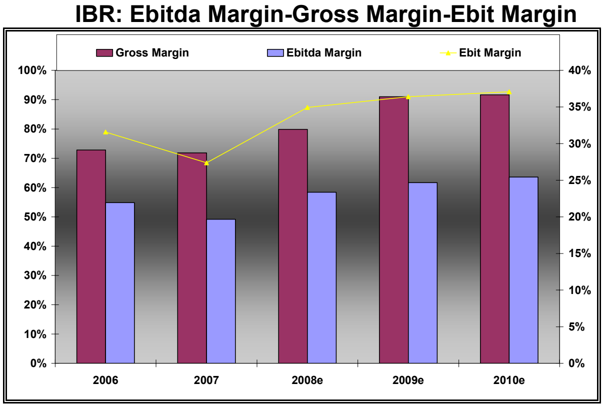
FY2008 results were quite positive in terms of the increase in renewable installed capacity, improvement in Ebitda margin, stable financial cost and sustainable level of Net Debt. Although, we believe IBR 2010 and 2012 targets both in term of Ebitda and Net profit are too optimistic and they represent the best case scenario. We forecast a 2008-2012e CAGR of EBITDA and Net Profit of [illegible]% with top line growing at a pace of 22%. Renewable Ebitda/Renewable Gross margin will increase to 76% in 2010e and 78% in 2012e with Group Ebitda Margin at 68% in 2012e. Given that, we expect 2010 Ebitda and Net Profit of respectively Eur 2.02 bn and Eur 584 mn, below Eur 2.4 bn and Eur 80[illegible] mn of IBR guidance. IBR target of Renewable Ebitda/ Renewable Gross margin of 80% will be missed both in 2010 and 2012. Our average ROIC during 2009e-2012e is 4.5%, lower ~300 bp compared to Company's WACC of 7.[illegible]7%, thus generating a negative cumulated EVA of ~Eur 2.34 bn during the same period. In order to sustain its Capex Plan and the Payout policy and keep the gearing below 50% in 2012 IBR still needs to inject liquidity for ~Eur [illegible] bn. Most of the value of the Company is in the Renewable energy development pipeline, more than [illegible] larger than competitors, that will guarantee the Company being N°1 in Renewable energy in the coming years. We believe IBR will increase its Gas storage business in North America (now N°3 in North America for independent gas storage) thus allowing the Company to add stable Cash Flow and reducing its Risk profile. We are [illegible] positive on IBR (given long term PPAs contract at fixed price, floor prices mechanism, feed[illegible] being able to continue to add stable and reliable cash flow and to gradually increase [illegible] investment going forward. Between the group of peers IBR guarantees margins in the high end range in addition to the healthiest Net Debt:Equity structure and best pay-out ratio. We value IBR using a DCF methodology, adopting a WACC of 7.28% (5.5% cost of debt, 4.30% free risk rate, beta=0.92, risk premium=4%, target gearing=20[illegible]), a 15 years forecast period and a perpetual growth rate of 3%. The DCF based fair value is Eur 3.6[illegible]. The weighted average of DCF based fair value and multiple mean reversion based fair value brings to a valuation of Eur [illegible].36. On top of this We add Eur 2 as of the value of the pipeline.

IBR: Revenues-Gross Profit-Ebitda-Ebit



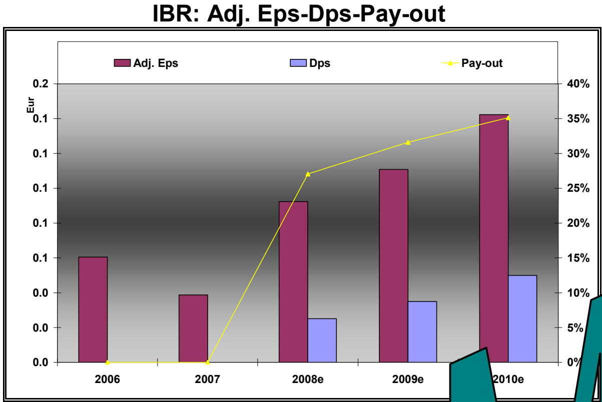
Source: Company data; EET research

IBR: Ebitda Margin-Gross Margin-Ebit Margin



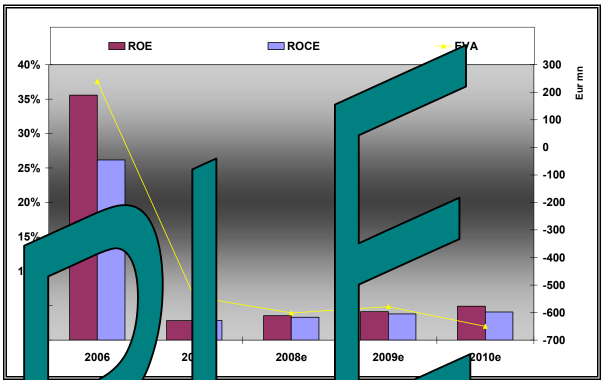
Source: Company data; EET research

IBR: Adj. Eps-Dps-Pay-out



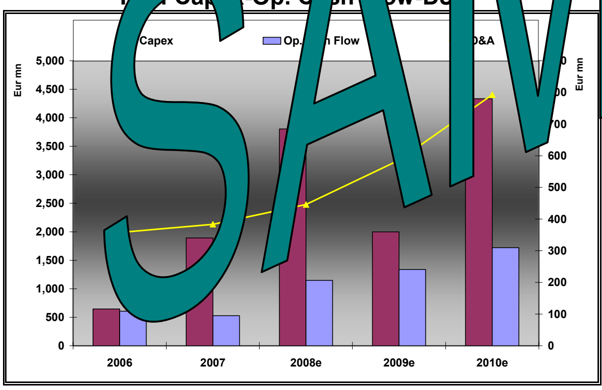
Source: Company data; EET research

IBR: ROE-ROCE-EVA



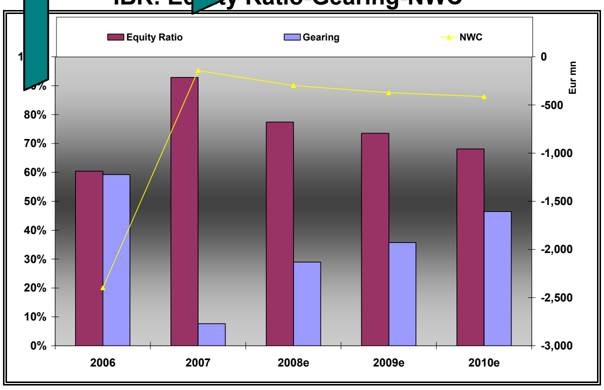
Source: Company data; EET research

IBR: Capex-Op. Cash Flow-D&A



Source: Company data; EET research

IBR: Equity Ratio-Gearing-NWC



Source: Company data; EET research

Iberdrola Renovables - Income statement

EUR mn (Yr. End: 12/31)	2007	2008	2009e	2010e	2011e
Net sales	**1,581**	**2,030**	**2,477**	**3,180**	**3,902**
Cost of sales	-445	-409	-223	-409	-256
Gross profit (loss)	**1,136**	**1,621**	**2,254**	**2,915**	**3,646**
Net Operating Cost&Charge	-359	-436	-677	-828	-951
Ebitda	**777**	**1,185**	**1,528**	**2,023**	**2,617**
D&A	-384	-446	-586	-793	-926
Warranty Provisions	39	-30	-37	-48	-59
EBIT	**433**	**709**	**902**	**1,179**	**1,629**
Net financial	-198	-122	-209	-299	-360
Profit and Loss of non current assets	-12	-6	0	0	0
Extraordinary Items	1	0	0	0	0
EBT	**223**	**582**	**693**	**880**	**1,269**
Income tax benefit (expense)	-48	-185	-229	-291	-419
Net Income Before Min. Int.	**175**	**397**	**464**	**590**	**850**
Minority's interest	-11	-7	-13	-18	-26
Net Income	**164**	**390**	**452**	**572**	**825**

Source: Company Data, EET forecasts

Iberdrola Renovables - Balance Sheet

EUR mn (Yr. End: 12/31)	2007	2008	2009e	2010e	2011e
Intangible Assets (Godwill included)	4,284	4,493	4,647	4,787	4,962
Property, plant and equipment net	9,696	12,875	14,308	17,867	21,293
Other Non Current Financial Assets	301	321	321	321	321
Long-Term Trade Receivables	388	20	20	20	20
Deferred tax assets	265	364	364	364	364
Total non-current assets	**14,934**	**18,073**	**19,660**	**23,359**	**26,960**
Inventories	200	221	248	[illegible]	351
Trade and other receivables	1,618	614	1,084	[illegible]	1,749
Government Bodies	266	246	246	246	246
Other current financial assets	352	775	775	775	775
Cash and cash equivalent	214	287	287	287	287
Total current assets	**2,650**	**2,144**	[illegible]	[illegible]	**3,409**
Total Assets	**17,584**	[illegible]	[illegible]	[illegible]	**30,369**
Minority Shareholders	135	[illegible]	86	104	129
Shareholder's Equity	[illegible]	[illegible]	[illegible]	[illegible]	14,999
Total Equity	[illegible]	[illegible]	[illegible]	[illegible]	**15,128**
Deferred revenues	143	[illegible]	146	146	146
Long-term Provisions	63	[illegible]	148	198	258
Deferred Tax Liabilities	[illegible]	[illegible]	[illegible]	1,956	1,956
Other long-term accounts payable	282	[illegible]	339	339	339
Long-term financial debt	746	[illegible]	3,614	5,346	6,451
Capital instruments similar to long-term liabilities	681	[illegible]	798	798	798
Total non current liabilities	[illegible]	[illegible]	**7,001**	**8,783**	**9,948**
Trade Creditors and other Short-term accounts	[illegible]	2,481	2,725	3,180	3,590
Short-term Provisions	[illegible]	0	0	0	0
Short-term financial debt	296	300	1,027	1,461	1,703
Total current liabilities	**2,874**	**2,782**	**3,752**	**4,641**	**5,293**
Total equity & liabilities	**17,584**	**20,216**	**22,300**	**26,413**	**30,369**

Source: Company Data, EET forecasts

Iberdrola Renovables - Cash Flow statement					
EUR mn (Yr. End: 12/31)	**2008**	**2009e**	**2010e**	**2011e**	**2012e**
Net Income Before Min. Int.	397	464	590	850	1,038
D&A	476	586	793	926	1,064
Subsidies applied and other revenue to be distributed	-2	-	-	-	-
Financial Revenues and Expenses	122	-	-	[illegible]	-
Other provisions for pensions	2	2	2	[illegible]	2
Provisions for risks and liabilities	3	37	48	[illegible]	68
Profit/ Loss on the disposal of non-current assets	6	-	-	-	-
Adj. Net cash from operation	**1,004**	**1,089**	**1,432**	**1,837**	**2,173**
Changes in working capital	723	73	[illegible]	55	-13
Cash flow from operating activities	**1,727**	**[illegible]**	**[illegible]**	**[illegible]**	**2,160**
Cash flow from investment activities:					
Acquisition of intangible assets	-199	[illegible]	[illegible]	-195	-182
Acquisition of property, plant and equipment	[illegible]	[illegible]	[illegible]	-4,332	-4,332
Charges for the disposal of tangible assets	[illegible]	[illegible]	-	-	-
Other adjustments	[illegible]	[illegible]	-	[illegible]	-
Net cash from investing activities	**[illegible]**	**[illegible]**	**[illegible]**	**[illegible]**	**-4,514**
Cash flow from financing activities:					
Issue/(purchase) of equity	[illegible]	[illegible]	[illegible]	1,500	1,500
Subsidies of capital and other revenues to be distributed	[illegible]	[illegible]	[illegible]	-	-
Change in working capital from current financial debt	[illegible]	[illegible]	-	-	-
Cash entries for long-term debt	[illegible]	[illegible]	-	-	-
Repayment of financial debt	-152	[illegible]	-	-	-
Interest paid including capitalised interest	-234	-	-	-	-
Dividends paid	-	-106	-148	-211	-338
Net cash flow from financing activities	**2,507**	**-106**	**852**	**1,289**	**1,162**
Net Increase (Decrease) in Cash and Cash Equivalents	73	-1,117	-2,166	-1,347	-1,192
Cash and Cash Equivalents at Beginning of Period	214	214	214	214	214
Cash and Cash Equivalents at End of Period	**287**	**-903**	**-1,952**	**-1,133**	**-978**
Free Cash Flow [illegible]					
Cash from Operations	2,134	1,302	1,673	2,133	2,444
Capital Expenditures	-3,880	-2,173	-4,491	-4,527	-4,514
Free Cash Flow	**-1,747**	**-871**	**-2,818**	**-2,394**	**-2,070**
Free Cash Flow per Share	-0.41	-0.21	-0.67	-0.57	-0.49

Source: Company Data, EET forecasts

Key ratios

Key ratios and figures					
EUR (Yr. End: 12/31)	**2007**	**2008**	**2009e**	**2010e**	**2011e**
Profitability					
% Gross Margin	71.9%	79.8%	91.0%	91.6%	93.4%
% Ebitda margin	49.2	58.4	61.7	63.6	67.1
% Ebit margin	27.4	34.9	36.4	37.1	41.7
% Profit margin	10.4	19.2	18.2	18.0	21.1
ROE%	2.8	3.6	4.0	4.7	5.9
ROIC%	2.9	3.3	3.8	4.0	4.7
Net Profit After Tax / Net Sales	11.1%	19.6%	18.7%	18.5%	21.8%
Operating Cost / Net Sales	48.4%	43.1%	37.8%	40.4%	32.4%
Non Operating Cost / Net Sales	16.3%	15.4%	17.7%	18.5%	20.0%
Net Profit After Tax / Invested Capital	1.5%	2.7%	2.9%	3.0%	3.7%
Growth Rates YoY					
Sales	2.8%	28.5%	22.0%	28.4%	22.7%
Ebitda	-7.8%	52.5%	28.9%	[illegible]	29.4%
Ebit	-10.9%	64.0%	27.1%	[illegible]	38.1%
Eps	-35.9%	138.2%	15.8%	[illegible]	44.2%
Efficiency					
NWC / Sales	-8.9%	-14.7%	[illegible]	[illegible]	-12.0%
Capex / Sales	119.7%	187.3%	[illegible]	[illegible]	111.0%
Net Sales / Invested Capital	13.4%	[illegible]	[illegible]	[illegible]	16.8%
Liquidity					
Operating Cash Flow / Net Sales	-32.2%	[illegible]	[illegible]	[illegible]	48.5%
Free Cash Flow / Net Sales	-33.3%	[illegible]	[illegible]	[illegible]	-61.4%
Net Debt/ EV	[illegible]	[illegible]	25.4%	33.7%	38.1%
Net Debt/ Equity	[illegible]	[illegible]	37.7%	50.2%	52.0%
Net Debt / Ebi[illegible]	[illegible]	[illegible]	2.9	3.2	3.0
Interest Cove[illegible]	[illegible]	[illegible]	4.3	3.9	4.5
EVA (Eur mn[illegible]	[illegible]	[illegible]	-563	-644	-600
Valuation					
EV/SALES	[illegible]	10.0	6.9	6.1	5.3
EV/EBITDA	[illegible]	17.1	11.2	9.6	7.9
EV/EBIT	[illegible]	28.5	19.0	16.4	12.7
PER	139.6	43.6	28.3	22.4	15.5
P/CF Adj.	44.8	19.6	11.9	9.1	7.1
P/BV	2.1	1.5	1.1	1.0	0.8
Yield	0.0%	0.0%	1.2%	1.7%	2.6%
FCF Yield	-7.5%	0.0%	-6.8%	-22.0%	-18.7%
Expenses ratios					
Raw materials/Sales	-28.2%	-20.1%	-9.0%	-12.9%	-6.6%
Net operating cost and charge/Sales	-22.7%	-5.2%	-9.0%	-9.0%	-9.2%
Amortization/Sales	-24.3%	0.0%	-1.4%	-1.0%	-1.0%
Provisions/Sales	2.5%	-1.5%	-1.0%	-1.0%	-0.5%
Asset Utilization					
Net Sales / Employees	2	2	3	3	4
Net Sales / Net Assets	13%	14%	15%	16%	17%
Net Profit / Net Assets	1.4%	0.0%	0.0%	0.0%	0.0%

Source: Company Data, EET forecasts

Stock ratings definition

- **Outperform (O):** The stock's total return is expected to exceed the industry average* by at least 10-15% (or more, depending on perceived risk) over the next 12 months.
- **Neutral (N):** The stock's total return is expected to be in line with the industry average (range of ±10%) over the next 12 months.
- **Underperform (U):** The stock's total return is expected to underperform the industry average* by 10-15% or more over the next 12 months.

*The industry average refers to the average total return of the relevant country or regional index.

Methodology: Our target price is based on EVA/DCF analysis, assuming a WACC of 7.28% and a terminal Growth rate of 3%.

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