

IBERDROLA

UTILITIES SECTOR

STUDENT: VASCO CONCEIÇÃO

COMPANY REPORT

7 JANUARY 2012

The Future is Renewable

Dynamic growth opportunities in the renewables

- We have initiated our coverage with a price target of **€6.32** per share, corresponding to a **BUY** recommendation as there is an upside potential of **54%** relative to today's price.
- The company's focus in the regulated business is highly justifiable as it provides a stable and sustainable business. Reinforcing the presence in Brasil and strength domestic, UK and USA networks will produce resilience cash flows.
- Iberdrola seems to already recognize the liberalized activities as the less attractive business due its excessive volatility (more exposed to market risks). The business has been excessively exposed to lower demand and lower prices in some countries as well as the current regulatory framework in Spain and UK suggests lower growth projects.
- In line with the energy trends (investments of low CO2 energies), Iberdrola will be very committed in the upcoming years on the strengthening of its worldwide leadership in renewable energies. This segment is expected to produce the most dynamic growth in the next years: EBITDA CAGR of 6% during 2012-2019.
- Even though Iberdrola is still very focused on cost-cutting, investment slowdown and disposal plan to reduce costs and debt level we strongly believe the current capital structure is manageable. However, the ability to deleverage the balance sheet while retaining more cash flow generation than asset disposals will be the key point to unlocking Iberdrola's fair valuation.

Company description

Iberdrola is a Spanish-based electric utility engaged on four main segments: regulated, liberalized, renewables, and other businesses. In 2001 the company implemented its growth and international expansion plan which has become Iberdrola as the Spain's largest energy group by market capitalisation, the global leader in wind energy and one of the world's largest utilities by market capitalization.

Recommendation:	BUY
------------------------	------------

Price Target FY13:	6.32 €
---------------------------	---------------

<i>Upside Potential</i>	<i>54%</i>
-------------------------	------------

Price (as of 4-Jan-13)	4.11 €
-------------------------------	---------------

Reuters: IBE.MC, Bloomberg: IBE SM

52-week range (€)	2.63-4.63
-------------------	-----------

Market Cap (€m)	25.230,85
-----------------	-----------

Outstanding Shares (m)	6.138,89
------------------------	----------

Source: Bloomberg



Source: Bloomberg

(Values in € millions)	2011	2012E	2013F
Revenues	31.648	34.412	35.869
EBITDA	7.650	8.037	8.444
EBITDA Margin	24.2%	23.4%	23.5%
EBIT	4.505	4.868	5.171
Debt/Assets	0.65	0.66	0.66
Net Debt/EBITDA	4.25	4.11	4.11
Net Debt/Equity	0.98	0.98	1.02
EBITDA/Interest Expenses	5.2	5.0	5.0
ROCE	6.6%	7.1%	7.3%
Net Profit	2.805	3.231	3.589

Source: Iberdrola and Analyst Estimates

THIS REPORT WAS PREPARED BY "STUDENT'S NAME", A MASTERS IN FINANCE STUDENT OF THE NOVA SCHOOL OF BUSINESS AND ECONOMICS, EXCLUSIVELY FOR ACADEMIC PURPOSES. THIS REPORT WAS SUPERVISED BY ROSÁRIO ANDRÉ WHO REVIEWED THE VALUATION METHODOLOGY AND THE FINANCIAL MODEL. (SEE DISCLOSURES AND DISCLAIMERS AT END OF DOCUMENT)

Table of Contents

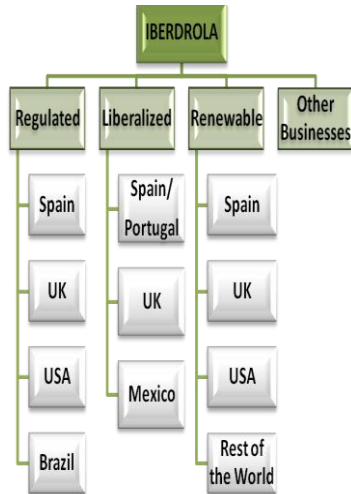
COMPANY OVERVIEW.....	3
COMPANY DESCRIPTION.....	3
SHAREHOLDER STRUCTURE	4
REGULATED BUSINESS.....	5
SPAIN: “ NEW REMUNERATION MODEL PLAYS A ROLE”	5
UK: “LOW RISK, MATURE AND STABLE BUSINESS”	7
USA: “SIGNIFICANT CHALLENGES OVER THE NEXT YEARS”	10
BRAZIL: “ STRENGTHENING IN A FASTEST GROWING COUNTRY”	13
VALUATION	15
SENSITIVITY ANALYSIS	16
LIBERALIZED BUSINESS	18
SPAIN (PORTUGAL): “PRESSURED BY INNEFICIENT TECHNOLOGIES”	18
UK: “CARBON TAX POSES A CHALLENGE”	20
MEXICO: “STABLE BUSINESS – PPA AGREEMENTS”	21
VALUATION	22
SENSITIVITY ANALYSIS	22
RENEWABLE BUSINESS.....	23
VALUATION	24
SENSITIVITY ANALYSIS	25
SUM-OF-THE-PARTS.....	26
VALUATION	26
WORST CASE SCENARIO (15% PROBABILITY)	29
RISK FACTORS	31
THE PROBLEM OF TARIFF DEFICIT	32
FINANCIALS	34
APPENDIX.....	35
BALANCE SHEET (BASE SCENARIO)	35
INCOME STATEMENT (BASE SCENARIO)	36
STATEMENT OF CASH FLOWS (BASE SCENARIO	36
HOLDINGS	37
COMPARABLES	37
RESEARCH RECOMMENDATIONS.....	38

Company overview

Company Description

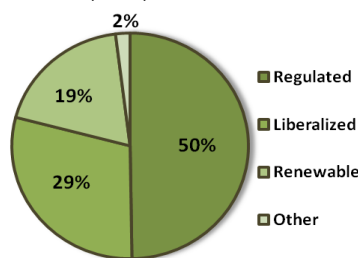
Iberdrola is a Spanish-based listed company in the Madrid Stock Exchange being one of the Spanish’s main companies on the Ibex 35 by market capitalization. The company was founded in 1992 as a result of the merger between Hidroeléctrica Española and Iberduero. Currently, it is one of the most important Spanish companies representing the Spain’s largest energy group, the world leader in wind energy and a major player in the power industry worldwide over the past few years. The international expansion has been a key major driving force behind Iberdrola’s performance since it went through its growth and international expansion plan in 2001. Iberdrola primarily operates through its four main business segments: regulated business, liberalized business, renewable energy business, and other businesses. The regulated business comprises not only the energy transmission and distribution businesses but also those of any other regulated nature, originating in Spain, United Kingdom (UK), United States of America (USA) and Brazil. The liberalized business encompasses energy generation and supply activities related to the selling of energy to deregulated customers carried on by the group in Spain, Portugal, UK and Mexico. The renewable business includes activities relating to renewable energies in Spain, UK, USA and the rest of the world, and the gas trading and storage businesses in USA. Last but not least, the other businesses are the engineering and construction businesses, non-power businesses and gas activities in Canada. Historically, the regulated business has been the most relevant contributor to Iberdrola’s earnings before interest, taxes, depreciation and amortization (EBITDA) followed by the liberalized and the renewable business (see Graph 1). Over the last years, Iberdrola has shifted from the predominante domestic business to become a different company with activites all over the world. The expansion has not only been organic but also non-organic, which includes several key acquisitions: Scottish Power (SP) in UK, Energy East in USA, and Elektro in Brazil. In what concerns organic growth, Iberdrola has strongly bet on renewable energies being the first electric utility in the world that strongly invested on the development of renewables which has allowed the company to become the number one in wind energy. There were two main growth phases: the 1st phase (from 2001 to 2006) included the growth of renewable energies and generation in countries such as Spain, Mexico and Brazil while the 2nd phase (beginning in 2007) was characterized by the internationalization with the acquisitions of SP, Energy East and Elektro representing the key milestones as well as the strenghtening of its worldwide leadership in renewable energies.

Figure 1: Iberdrola Segmentation



(Source: Iberdrola)

Graph 1: Segment Contribution to EBITDA (2011)



(Source: Iberdrola, Analyst Estimates)

Non-organic growth included several key acquisitions

There were two main stages on its growth plan

Shareholder Structure

ACS is the biggest shareholder

Figure 2: Shareholder Structure

SHAREHOLDER STRUCTURE	%
ACS	14,90%
Kutchabank	5,40%
Qatar Investment Authority	8,30%
Bancaja	5,30%
Free-Float	66,20%

(Source: Iberdrola, Bloomberg)

ACS (formally Actividades de Construcción y Servicios), a leading construction company in the world with projects in many countries worldwide, is the biggest shareholder representing the most significant shareholding in the company. The company owned approximately 14,90% of the company's ownership. The remaining important shareholding blocks are: Kutxabank, Qatar Investment Authority and Bankia (Bancaja) (see Figure 2). The remaining 66,20% constitute free-float which has been listed for trading in the Madrid Stock Exchange. Lately, overhang concerns have arisen due to the current macroeconomic situation. On 18th April, ACS, the Spanish construction group sold 3,69% stake under an accelerated bookbuilding process either to help cover the margin calls of the loans taken to buy the stake in Iberdrola or to help pay other debt maturities in the group. Iberdrola's share underperformance at the time – the shares had dropped 16% in the preceding 20 days – triggered higher margin deposits in ACS's equity swap agreements, one of the main instruments through which ACS had built up its stake in Iberdrola. Prior to the announcement of the deal, ACS had unsuccessfully attempted to take over management of the Spanish company through repeated attempts to place representatives on to the utility's board of directors. In order to prevent ACS from gaining influence over the company, Iberdrola had been blocking shareholders' voting rights even after new corporate regulations ruled that it is illegal for companies to cap shareholders' voting rights. Given their highly leveraged structure and/or need to improve liquidity, not only ACS but also Bankia, which is struggling with financial difficulties, are on the top of the overhang risk. As mentioned before, Bankia has a stake on Iberdrola and the option to increase liquidity and strength balance sheet via asset disposals has not yet been confirmed nor denied by the company. However, several offsetting factors should be taken into consideration. Firstly, ACS announced that it has renegotiated the financial instruments to keep its stable ownership of Iberdrola for at least the next three years. Moreover, the ACS's financial situation has improved since it sold its stake in Iberdrola. Subsequently, it disposed 10% ownership in Abertis amounting €875mn, sold seven transmission lines in Brazil for €752mn, and bank refinancing to the tune of €506mn, as well as renegotiating Iberdrola's debt instrument mechanisms. Besides that, after the annual general meeting, in a press conference, Iberdrola's Chairman reiterated that the company is considering buying back the shares held by state-rescued lender Bankia even though a final decision has not yet been taken. In sum, despite the fully justifiable overhang risks that ACS and Bankia could reduce their stakes the offsetting factors might be strong enough to remove the idea spread by some analysts and investors that Iberdrola presents a fragile shareholder structure.

Despite some overhang risks, there are significant offsetting factors

Iberdrola may buy back the shares held by state-rescued Bankia

Regulated Business

Since 1st January all regulated operations were integrated

The regulated business operated by the company includes the energy transmission and distribution businesses, as well as those of any other regulated nature, located in Spain, UK, USA and Brazil. As previously mentioned, it is by far the most important Iberdrola's activity, accounting for approximately 50% of 2011 EBITDA. Since 1st January 2011, all Iberdrola's regulated activities were integrated in a sole business area aiming to create synergies, optimize structures and to increase operational efficiency.

Spain: "New remuneration model plays a role"

Figure 3: Electricity Regulated Retail in Iberia (TWh)

Market Share	2010	2011
Endesa	31%	31%
IBERDROLA	26%	25%
EDP/HC	32%	32%
Gas Natural Fenosa	11%	11%
Others	1%	1%

(Source: EDP)

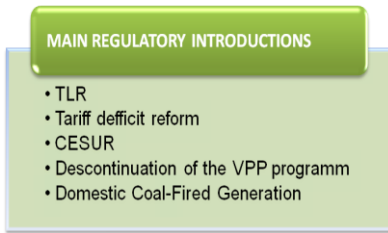
CNE is the Spanish regulator of the energy systems

Four years will constitute the time frame for regulatory period

Electric power transmission, a process in the delivery of electricity to consumers, constitutes the bulk transfer of electrical power. Red Eletrica Espanola (REE) carries on the transmission of electric power and is responsible for the operation of the power system along with the management of the transmission grid in order to guarantee electricity supply and proper coordination between the supply and transmission system, as well as the management of international electricity flows. As recommended by the European Commission, REE in Spain or REN in Portugal constitutes independent operators in order to ensure the appropriate competitive access to the network in a non-discriminatory, transparent and fairly priced way. In other words, it is necessary that the independence of the distribution system operators and the transmission system operators be guaranteed especially with regard to generation and supply interests¹. REE's transmission grid is composed of more than 40,100 kilometres of high voltage electricity lines and more than 4,800 substation bays, and has more than 74,000 MVA of transformer capacity. As a regulated activity, the transport and distribution are not subjected to the free competition and market regime being Endesa, EDP/HC, and Gas Natural Fenosa the main players in the electricity distribution industry (see Figure 3). The National Energy Commission (CNE – Comission Nacional de Energia) is the entity responsible for the regulation and supervision of the energy sector in Spain. Since it is not an independent body from the Spanish Government, CNE is the regulatory authority that has legislative powers to regulate the energy sector. The remuneration paid for distribution activities will be set for regulatory periods of four years and will be calculated using a reference network model as a technical comparison tool. A reference network model is a model that maps out, for all Spanish territory, the areas in which each distributor is active and determines the reference distribution network needed to link up the transmission network, where applicable, and

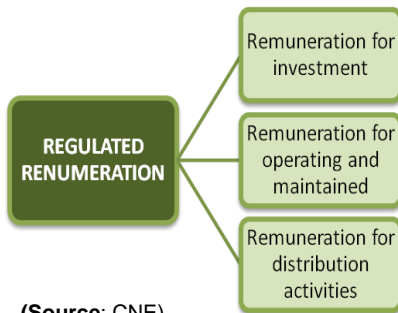
¹ Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003.

Figure 4: Administrative Regulation



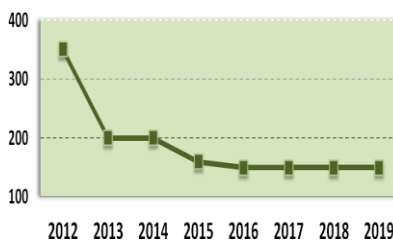
(Source: Literature Review)

Figure 5: Remuneration in Spain



(Source: CNE)

Graph 2: Investment Plan (Eur m)



(Source: Iberdrola, Analyst Estimates)

distribution network with the final consumers of electricity, based on their geographical location, feed voltage and demand for power and electricity². As of December 2011, Iberdrola managed more than 10.6 million supply points and the total energy distributed amounted to 96,379 GWh. The domestic business was the largest contributor to the company’s fiscal year 2011 EBITDA accounting for approximately 41% of the total. The Spanish gas and electricity system has been subjected to a complex administrative regulation since the late 2007 with the introduction of tariffs of last resort (TLR) in both gas and electricity (in mid-2008 and mid-2009, respectively), the reform of the mechanism for the determination and recovery of the tariff deficit, the continuation of the programme of procurement auctions (CESUR) used to set the cost of energy for residential electricity customers but the discontinuation of the virtual power plant (VPP) programme applied to the largest generators, and the measures on solar subsidies and domestic coal-fired generation³ (see Figure 4). According to the Spanish network legislation, remuneration is a function of the costs incurred in the process and certain efficiency metrics. There are three main inputs to calculate the remuneration: the remuneration for investment, the remuneration for operating and maintained, and the remuneration of all costs necessary to the exercise of distribution activities which will include commercial management, network planning and energy management costs (see Figure 5). Within each period the remuneration is then calculated by updating the base remuneration of the past year (taking into account the CPI and IPRI) and adding up the remuneration for the new investments made. Annual incentives are also set for enhancing quality and reducing losses. Due to the gap between revenues from supply and access tariffs and fees for the transmission or distribution grids and the recognized costs charged in the several different activities and regulated costs of the electricity system, the Spanish electricity market has presented a structural revenue deficit in its regulated activities for a decade now⁴. Furthermore, the overall economic outlook in Spain may require additional downside risks as there is growing concerns about the consumption levels in the future since the general landscape as of the end of the previous year indicates us energy consumptions at 2007 levels. Adapting investments to the new regulatory framework currently in development along with maximizing efficiency may be the key aspects to generate resilience cash flows. In the 2012-2014 regulatory adaptation period to the new remuneration system, Iberdrola will invest around €750 Million (€350 Million in 2012, €200 Million in 2013 and the same amount in 2014) mostly in growth to strength its power network (the gross

² Annual Report, Iberdrola. 2011. “Legislation applying to regulated activities”

³ Giulio Federico, “The Spanish Gas and Electricity Sector: Regulation, Markets and Environmental Policies

⁴ Please consult “The Problem of Tariff Deficit” section in this report for more information on this issue

percentage) and the remaining part in refurbishment (see Graph 2). Since regulation has produced a significant need for adaptation as well as regulatory uncertainty risk is still increasing the company will focus on efficiency improvement (workforce reduction – 250 employees, lower contractor costs, re-engineering process) obtaining savings against inflation and activity increase. Expectedly, in line with the company expectations the networks business in Spain will reflect in the next year the cut in the new remuneration similar to the countries in which Iberdrola operate. The main adjustments came from the downward revision of distribution revenues as reported in the Royal Decree 13/2012. The set of measures ruled out through the article 5 on the aforementioned legislation includes the following to take effect from 1st January onwards⁵.

- ✓ Assets in operation that have not been fully depreciated will be remunerated as an investment, and their net value will be taken as the basis for remunerating the investment;
- ✓ The remuneration earned by distribution facilities brought into operation in year n will start to accrue from January 1 of year n+2.

In the forecasting approach, we assumed the revenues will be estimated according to the resolution laid down by the IET 3586/2011. The revenue per unit distributed will be 7% lower in the next year as a result of the cut in the remuneration and its adaptation period. Also, we maintained a steady 19.4% Operational Expenditures/Gross Margin (OPEX/GM) ratio along the valuation model which represents an approximately 1% decrease compared to the OPEX/GM ratio in 2010 and close to the ratio registered in 2011 (19.27%). In the presentation of the 1st Quarter Earnings, Iberdrola said that the cut of distribution revenues led to a decrease of €58mn in the earnings of the first quarter. We estimated the overall cut this year to be approximately €223 Million in comparison to the net income reported by the company in 2011. We assumed the energy distributed breakdown in the last year to remain constant from 2012 onwards (see Figure 6). Moreover, we extended the distribution revenue cut in 2012 to the perpetuity in our forecasting. Our valuation assumes an EBITDA margin of 77%, which is in line with the historical data.

UK: “Low risk, mature and stable business”

In its UK-regulated power business, the Spanish multinational company distributed to more than 3.4 million customers in the last year. In this country the

Downward revision of distribution revenues

Our projections indicate a 7% decrease in the revenue per unit distributed in the next year

Figure 6: Energy Distributed

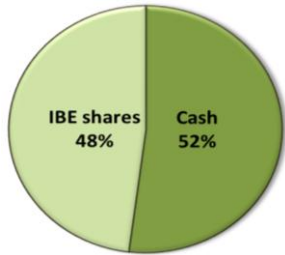
Energy Distributed Breakdown	%
Residential	25%
Industry	40%
Services	35%
Total	100%

(Source: Iberdrola)

SP Energy Networks distributes to more than 3.4 million customers

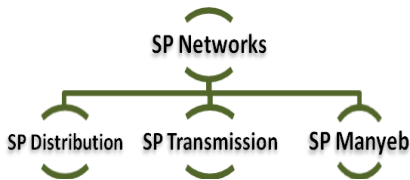
⁵ Garrigues, “New Energy Industry Regulation in RD 13/2012 on the gap between revenues and expenses in the electricity and gas expenses”

Graph 3: Iberdrola-SP deal



(Source: Scottish Power)

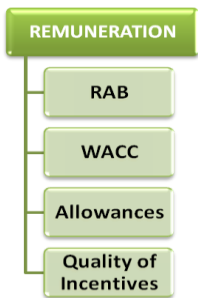
Figure 7: SP Energy Networks Segmentation



(Source: Scottish Power)

Sector-specific legislation frames the regulation in UK

Figure 8: Remuneration in UK



(Source: Ofgem)

Iberdrola’s presence in UK has been characterized by a stable regulatory environment

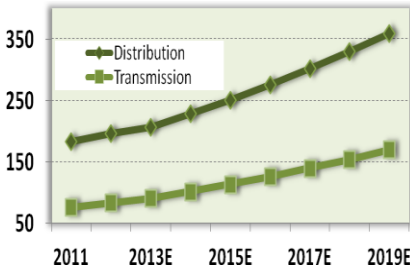
set of services is offered through its fully vertically integrated energy subsidiary Scottish Power (SP) headquartered in Glasgow, Scotland. Following the privatization of the previously state-owned Scottish Electricity industry SP was founded in 1990. In 23th April 2007 Iberdrola acquired all issued ordinary shares of SP: approximately 52% in exchange for cash or loan notes and the remaining 48% in Iberdrola shares (see Graph 3). The Iberdrola’s Chairman Ignacio Galan described the deal as the “birth of one of the largest energy companies in the world, with a total enterprise value of more than €65 Billion” effectively creating Europe’s third largest utility company. In the UK, energy networks are carried out by SP Distribution, SP Transmission, and SP Manweb (part of SP, therefore itself a subsidiary of Iberdrola). A fourth asset management business is SP Power Systems which maintains and repairs the distribution networks on behalf of the owners and acts as the distribution network operator (see Figure 7). During the last year the volume of energy distributed was 35,434 GWh. In terms of operational performance, in the 2010-2011 regulatory years SP Distribution ranked 5th with a score of 4.42 while the mean score for the sector for the 12-month period was 4.37. Moreover, SP Manweb was ranked 3rd out of 14 with a score of 4.49 out of 5. In UK, the framework for regulation of the energy industry is laid down principally by sector-specific legislation – the Electricity Act 1989 (as amended) in Great Britain and the Electricity (Northern Ireland) Order 1992 (as amended) in Northern Ireland – and the licences issued under it⁶. However, the regulators of the electricity industry also have recourse to powers under general competition legislation – the Competition Act 1998 and the Fair Trading Act 1973. The Office of Gas and Electricity Markets (Ofgem), as the industry regulator, administers a price control regime which ensures network operators can, through efficient operation, earn a fair return after capital and operating costs while limiting costs passed onto customers⁷. Remuneration is a function of a model based on the following inputs: regulatory asset base (RAB), Weighted Average Cost of Capital (WACC), allowances, and quality incentives (see Figure 8). Unlike the restless regulatory framework in Spain, important advances in the ‘design of Britain’s energy model’ in recent years has provided relative stable and predictable regulatory environment as basic pillar of the company’s presence in UK. For the upcoming years, we expect the government to put in place some of the already announced regulatory agreements in the short and long-term. In the Iberdrola’s Annual General Meeting, Ignacio Galan, Chairman of Iberdrola and SP reiterated his commitment to announce investments totalling €6 Billion over the next few years on upgrading the UK’s distribution and transmission system, as a result of the investment and regulatory certainty despite the economic

⁶ Simmonds, Gillion. 2002 edition. “Regulation of the UK electricity industry”

⁷ Ofgem. 2012. “Price Controls – Fact Sheet Update”

Iberdrola will invest €6 Billion on upgrading UK Networks

Graph 4: Allowed Revenues (£ m)



(Source: Analyst Estimates)

The compensation for regulated business is no longer linked to fluctuations in demand – DPCR5

uncertainty taking place in the Eurozone. With the recruitment of new engineers and technicians, Iberdrola will create 1,500 new jobs. Furthermore, Iberdrola intend to double its RAB strengthening its networks business. The UK distribution/transmission price control Ofgem proposals define the level of revenue that a given company in the energy utility sector is allowed to recover from its customers (allowed revenues). The regulatory framework derives this from an estimate of operating expenditure, capital expenditure, financing costs and corporation tax rate for the relevant period. These inputs are used, together with the regulatory asset value i.e. the value ascribed by Ofgem to the capital employed in the regulated business, to calculate the aforementioned allowed revenue (see Graph 4). The regulatory asset value (RAV) is adjusted each year to reflect asset additions, depreciation and the rate of inflation. The allowed revenue is then profiled across the price control period, determining the immediate change in revenues in the first year of the price control and the path of revenues over the remaining year (or ‘X’), with two key considerations being the financial profile of the businesses and the longer term trend in revenues⁸. In the distribution business, with the entry into force in April 2010 of the new remuneration established under the Distribution Price Control Review 5 (DPCR5) until April 2015 the compensation for regulated businesses is no longer linked to fluctuations in demand. The introduction of the latest regulatory framework has allowed Iberdrola to sustain an increased margin due to a larger RAB established under DPCR5 which resulted from the higher investments undertaken and committed. In the transmission business, the five-year formula known as RPI-X to control network prices (recognised to be a natural monopoly) is being replaced by the new RIIO framework (see Figure 9) that will form the basis for the next Transmission Price Control due to start in April 2013 covering an eight-year period through to 2020/21. RIIO-T1 will represent a significantly huge CAPEX programme: SP Transmission will have to raise close to £3 Billion with a three-fold increase in the RAV. According to our estimates, the headline WACC (before incentive potential) must be attractive enough to offset the current levels and regulatory decisions such as DPCR5. “RIIO-T1 will deliver significant organic growth in a low risk, mature and stable regulatory environment”, the company said in a presentation regarding the regulatory framework on electricity transmission in UK.⁹ Last but not least, a major construction will be the building of the first 420 km undersea cable uniting Scotland and England (being undertaken jointly with National Grid) that will create the largest project of this nature worldwide using leading-edge technology. Scottish Power announced the awarding of a £1 Billion contract to Siemens and cable manufacturer Prysmian. It

Figure 9: New RIIO Framework



(Source: Ofgem)

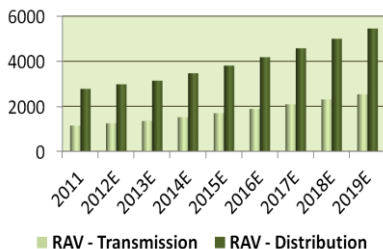
RIIO-T1 will require a capital outflow of approximately £3 Billion

⁸ National Grid, Investor Update December. 2007. “The UK electricity distribution price control”

⁹ Transmission UK, SP. 26th January 2012. “RIIO T1 Fast Track Overview”.

is due to be operational by 2016. According to our estimates, we believe the most relevant future investments will be placed either in UK or in US. We estimate CAPEX for the period 2012-2014 according to the company investment plan for the aforementioned years. In the next year, 58% of the capital expenditures will be used on the upgrading of the distribution networks while the remaining 42% will target the transmission business. In the period 2013-2014, transmission projects will cover most of the capital expenditures. Until the end of the explicit period we assume the percentage of capital expenditures allocated to each business to be constant from 2014 onwards in result of depreciation accumulated before and CAPEX will decrease in 2015 as a result of the end of the investments aforementioned. The allowances distributed were kept constant in 2012 at the value reported in 2011 but from 2013 onwards they will decrease in a linear manner (we assumed to be about 2%)¹⁰. The retail price control was assumed to growth at a constant rate (indexed to inflation) up to the end of the explicit period, except in 2012. We assumed a 10% cut in the remuneration growth rate in 2012 to reflect the adaptation period concerning the regulatory framework in course. Concerning the regulatory formula, other allowed operational expenditures will growth at the inflation rate through the explicit period, the depreciation expenditures will be based on a 20 year life basis, capital expenditures (concerning RAV – see Graph 5) will be the historical average of the period 2009-2012 assuming a 25% tax rate in the transmission business while in the distribution business will be 28% in the 2012-2019 period. The inputs to plug in the RPI-X Price Control Formula were assumed to be constant throughout the explicit period either in both segments (see Figure 10). Some final considerations should be made. Firstly, we assumed OPEX/GM ratio to decrease in a linear manner due efficiency improvements and OPEX to increase in a very equivalent pace as the evolution of RAB per year. Furthermore, GM evolves in a similar manner to the RAV and the EBITDA Margin will reach 85% in 2019 from the 82% in 2012 in result of significant investments made and operational savings (see Graph 6).

Graph 5: Expected RAV (Average Value) - £



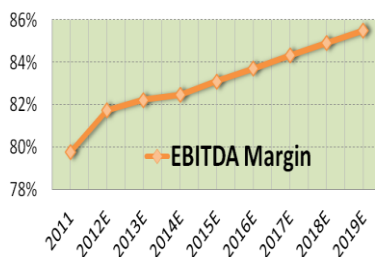
(Source: Analyst Estimates)

Figure 10: RPI-X Price Control Inputs

RPI-X Price Control	Distribution	Transmission
Allowed Vanilla Return	4,03%	4,26%
Tax Rate	28,00%	25,00%
Pre-Tax Vanilla Return	5,60%	5,68%
Incentives	1,00%	1,00%
Actual Vanilla Return	6,60%	6,68%

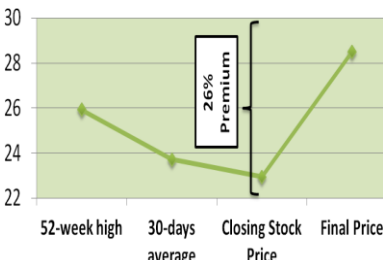
(Source: Analyst Estimates)

Graph 6: EBITDA Margin



(Source: Analyst Estimates)

Graph 7: Energy East Deal



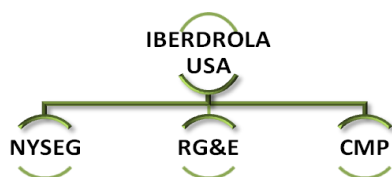
(Source: Analyst Estimates)

USA: "Significant challenges over the next years"

Iberdrola USA (formerly Energy East) is the leading operating subsidiary of Iberdrola in USA being a super-regional energy services and delivery company with operations throughout New England and New York State. In 17th September 2008 Iberdrola completed the acquisition of Energy East to broaden its regulated activities, offering a premium of 20.2% to the American-based company's

¹⁰ EU Legislation. "EU Emissions Trading Directive 2003/87/EC"

Figure 11: Iberdrola USA Seamentation



(Source: Iberdrola USA)

CNG, SCG and BGC were sold to help financing a major transmission lines upgrade

\$128 Million will be soon invested in improvements and upgrades in New York State

Graph 8: Allocation of Projected Rate Bases



(Source: Analyst Estimates)

The MPRP project is expected to result in an investment of approximately \$1,4 Million

shareholders over the average share price for the 30 days prior to the offer announcement (see Graph 7). The company would be renamed as Iberdrola USA in 2009. Regulated utilities in USA (see Figure 11), including New York State Electric & Gas (NYSEG), Rochester Gas and Electric (RG&E) and Central Maine Power (CMP), represent approximately 98% of the Iberdrola USA’s assets. In accordance with the last year’s annual report the wholly-owned subsidiary of Iberdrola had 1.86 million electricity supply points. The energy distributed during the year was 31,201 GWh and Iberdrola USA has approximately 0.56 Million Gas Users with 30,030 GWh gas supplied during the same period. This value represents a 1.1% increase when compared to the previous year, excluding the contribution from the Connecticut and Berkshire gas companies, which were sold during the last quarter of 2010. Connecticut Natural Gas (CNG), Southern Connecticut Gas (SCG) and Berkshire Gas Company (BGC) were sold to New Haven, Connecticut-based UIL Holdings Corporation. The proceeds of the transaction (the equity value received was approximately \$918 Million) were used to help finance a major upgrade of transmission lines linking Canada and New England, as will be explained later. They served a total of about 370.000 users. In line with Iberdrola’s Group strategic focus on networks, Iberdrola USA also announced infrastructure improvements in New York State investing about \$73 Million in infrastructure near Ithaca, New York, and spending \$55 Million on upgrades near Corning, New York. As the UK regulatory system, the American regulatory framework has provided a relative predictable environment for Iberdrola USA. In the distribution business, the conclusion of the tariff agreements (rate cases) in September 2010 provides visibility for Iberdrola USA companies for the coming years. The approved rate cases for all electric and gas distribution business lasts until December 2013¹¹, the economic incentives to operate are fully ensured and also there is obviously a relevant reduction of the volatility (protection against demand evolution, storm costs, pensions, taxes, and others). In sum, this should lead to a path of growth in results and a stronger financial and credit profile in the upcoming years. Regarding the Maine-based subsidiary, which encompasses CMP, a multi-annual rate case will be negotiated in 2013 which will come into effect in 2014. On the other hand, in the transmission business there are significant growth initiatives requiring significant capital expenditures on the way. The under construction Maine Power Reliability Program (MPRP) project, a project that will support the development of new renewable energy resources and help ensure long-term reliability for customers by increasing the capacity and efficiency of the New England’s transmission grid, will require an investment of approximately \$1.4

¹¹ Iberdrola reserves the right to expand tariff agreements further in 2014 (applied to New York-based companies – NYSEG and RG&E)

A scheme to roll out smart meters in Maine is now nearing completion costing \$192 Million

Figure 12: Projected ROE for each business

ROE (after tax)	INPUTS
NYSEG	
Electricity	10,00%
Gas	10,00%
RG&E	
Electricity	10,00%
Gas	10,00%
CMP	
Electricity/gas	10,50%

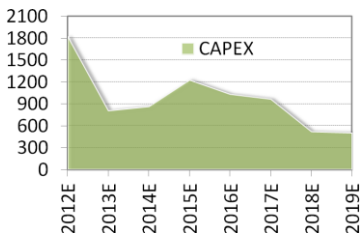
(Source: Analyst Estimates)

Figure 13: Equity Ratio to set

EQUITY	%
NYSEG	48,00%
RG&E	48,00%
CMP	49,60%

(Source: Analyst Estimates)

Graph 9: Estimated CAPEX



(Source: Analyst Estimates)

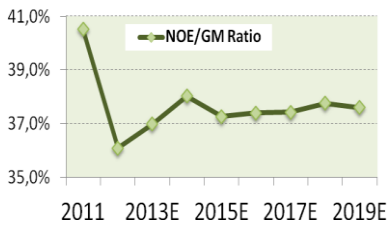
Billion and is expected to be completed in 2015. In the year ended in 2011 the investments associated with the project amounted to \$258 Million. This is the largest energy infrastructure project in the Maine’s history, and in the last 40 years represents the first upgrade of its electricity grid. Furthermore, there is also on progress a scheme to roll out smart meters in Maine. Iberdrola USA will invest \$192 Million on this project that is now nearing completion. It will benefit the 620,000 residential, commercial, and industrial customers of its subsidiary CMP. In the 3rd Quarter Presentation Results Iberdrola’s Chairman still announced that new investment opportunities are under analysis for the transmission business from 2015 onwards. In order to provide a realistic and accurate estimation with the data available and since no decision has been taken yet by Iberdrola we assumed no further capital outflows in new projects for the upcoming years. In USA, remuneration is a function of the legislation of each state and tariffs that are review in a short-time basis. The critical issue for the regulator includes how to estimate the earning drivers for regulated business, whether to add investments to the rate base (see Graph 8) as they are made or when the facilities go into service, the amount of depreciation, and whether expenditures have been prudently made and whether they relate to items that are used and useful for providing the utility service. Cost of capital is also called the allowed rate of return and is the interest that the company pays on its debt plus the return it must provide to shareholders to ensure they continue to invest in the company¹². For that purpose, we assumed a return-on-equity (ROE) for each business in each subsidiary as presented in the Figure 12 matching the historical values of the past 3 years and the average ROE estimated by the company for the period 2012-2014. As mentioned before, the total revenue requirement includes the total expenses incurred as well as the net profit potential¹³ which is a component of the rate base¹⁴ and the return of the equity component of the rate base. Iberdrola USA equity ratio (see Figure 13) in each subsidiary was also kept constant since no information available so far indicates any changes in that regard. All the expenses incurred to provide the utility service were calculated assuming a given percentage rate in each case. Regarding the CAPEX estimation, the already announced projects under construction were included in the forecasted capital expenditures on upgrading and growth projects as well as the costs of refurbishment of the assets (see Graph 9). In the period 2009-2011, NOE/GM (Net Operating Expenses/Gross Margin) has improved from 51% to 41% due reduction of external service and 20% reduction in workforce (without considering the sale of Connecticut). The company announced in its last quarter presentation

¹² Mark A. Jamison, University of Florida: “Rate of Return: Regulation”

¹³ Net Profit Potential = Rate Base * Equity Capital % * ROE, according to the USA Networks legislation

¹⁴ Rate Base is a function of the net plant, regulatory assets/liabilities and deferred taxes

Graph 10: NOE/GM Ratio

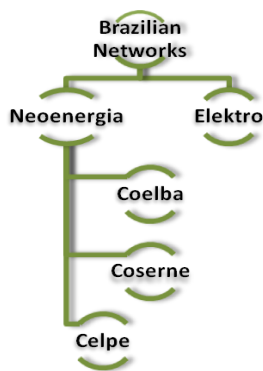


(Source: Analyst Estimates)

results the following target: NOE/GM ratio of 34% in 2014. In the projected Income Statement we do not expect Iberdrola to reach this goal even though as presented in the **Graph 10** Iberdrola will be in a better position to reach its objective which is in line with the company’s objectives to achieve all metrics avoiding penalties. In line with the approach used to value UK networks business GM evolves in a similar manner to the RAV, and the EBITDA Margin will range from 25,8% in 2012 to 24,2% at the end of the explicit period.

Brazil: “ Strenghtening in a fastest growing country”

Figure 14: Iberdrola in Brazil



(Source: Iberdrola)

The Brazilian-regulated power business is offered through Neoenergia (the holding company of electricity distributors Coelba, Cosern and Celpe) and Elektro (see **Figure 14**). Neoenergia, which Iberdrola is the leading shareholder since the late 1990s, is the largest private sector power distributor in Brazil. Despite most of the operational decisions are taken by the Spain’s largest energy company, it shares control with two government-led investors, Previ, Banco do Brasil’s employee pension fund, and Banco do Brasil. In the early 2011, in a bet that rapid growth in Latin America’s largest economy will offset its weaker domestic market Iberdrola cemented Brazilian presence as one of the key countries in its Latin American expansion with the \$2.4 Billion acquisition of electricity distribution company Elektro. With 2.3 Million customers and 15,458 GWh of energy supplied in 2011, the acquisition was carried out by purchasing 99.6% of the shares of the distributor which were property of the US group Ashmore Energy. The company ranks the third position in the State of São Paulo and the 30-year concession of Elektro has begun in 1998 to be ended in the late 2028 covering an area of approximately 120.000 km². The company has been reinforcing its presence in one of the fastest growing economies worldwide. The acquisition of Elektro reaffirms not only Iberdrola’s commitment to expand in one of the emerging markets viewed as key to its international growth strategy but also improves Iberdrola’s geographical diversification to reduce reliance on a domestic market where demand has significantly slowed down. **The Figure 15** presents the number of customers served by each distributor in the last year. Though Iberdrola is more engaged on the distribution business, the company is still investing on generation activities as will be mentioned later. Distribution wise, Iberdrola distributed 47,872 GWh in the last year¹⁵. Regarding generation, Iberdrola’s installed capacity encompasses hydro and thermal plans. The company intends to almost triple its capacity in the next ten years investing in hydro and wind plans. The regulated tariff reviews are set by the Agência

Figure 15: Number of Customers by Distributor (m)

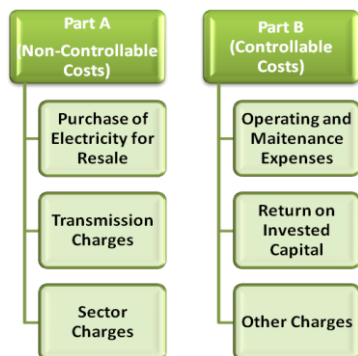
# Customers (M)	2011
Coelba	5,08
Coserne	1,16
Celpe	3,16
Elektro	2,25
TOTAL	11,65

(Source: Iberdrola)

The investment on Brazilian generation activities has increased

¹⁵ Elektro: Energy Distributed from 28/4 to 31/12. Period consolidated by Iberdrola. 15,458 GWh distributed in the entire year.

Figure 16: Several Sources of Income to the Distributors



(Source: EDP)

Whenever an extraordinary event happens, ANNEEL may perform an extraordinary review

Figure 17: Periodical Tariff Review Deadlines



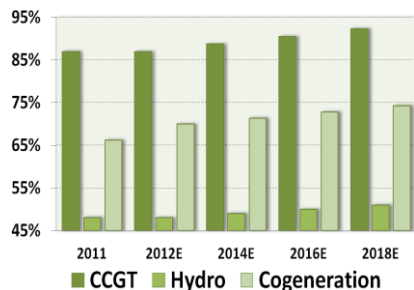
(Source: Iberdrola)

Nacional de Energia Elétrica (ANEEL), the Brazilian regulator, throughout the different concession areas. By fixing a given tariff, ANEEL ensures the economic and financial balance in each concession area. In other words, the annual income of the distributors should cover operating costs with the services providing a suitable return on the capital invested throughout the concession period. **The Figure 16** shows the various sources of income to the distribution concessionaires. In order to reflect proven significant changes in the company’s operating costs, regulated tariff is subject to regular tariff reviews and annual tariff adjustments as well as other extraordinary revisions. At approximate intervals of 3 to 5 years the periodical tariff revision is carried out in accordance with the concession contracts by calculating a suitable return upon the invested capital and an income required capable of covering efficient operational costs. On the other hand, in order to update the purchasing power of the income obtained by the distribution company in an annual basis, the annual tariff adjustment between two regular tariff reviews is carried out. Whenever an extraordinary event causes relevant changes in the company’s running costs putting at risk the financial and economic stability, the distributor company may ask ANNEEL to perform an extraordinary review. ANNEEL is also responsible for establishing the tariffs to the distribution and transmission systems by electricity sector's agents and the free (non-regulated) consumers. According to the energy sector legislation in Brazil, whenever a customer chooses the deregulated market instead of the regulated does not pay a regulated tariff to the local distribution company, after contracting electricity from another supplier. Instead, it will continue paying an access tariff to the local distributor¹⁶. In the distribution business, the process of defining the new rules for the 3rd cycle of tariff review, which started in 2010, has been completed after ANEEL approved the new average depreciation rates of fixed assets for Brazilian distributors. Elektro underwent its tariff review in August 2012¹⁷ while the Brazilian distributors of Neoenergia (Coelba, Celpe and Cosern) will possibly undergo their 3rd cycle of tariff review in April 2013 (see **Figure 17**). The new tariff methodology will create a new model for recognizing the cost of operation and maintenance (Benchmark Model), for assets retribution, regulatory depreciation, and non-payments provisions. In the next years, we expect the company to keep an attractive remuneration for distribution business in a solid and attractive country. In the generation/transmission business, a predictable and secure tendering model with fixed tariff yearly adjusted by inflation is the current regulatory framework. The regulatory environment provides not only a controlled investment risk (tendering with offer from contractor) but also access to Banco Nacional do Desenvolvimento (BNDES) financing in preferential conditions (60-

¹⁶ EDP. “Regulation and Tariffs: Electricity Tariffs in Brazil”

¹⁷ Elektro Tariff Review will have retroactive effects back to August 2011 when it should have passed the tariff review

Graph 11: Generation – Expected Load Factor for each technology



(Source: Iberdrola, Analyst Estimates)

Figure 18: Expected Total Generation Output (TWh)

TWh	CCGT	Hydro	Cogen
2011	1,56	1,81	0,21
2012E	1,55	1,81	0,22
2013E	1,57	1,83	0,22
2014E	1,59	1,84	0,23
2015E	1,60	1,86	0,23
2016E	1,62	1,88	0,23
2017E	1,63	1,90	0,23
2018E	1,65	1,92	0,23
2019E	1,67	1,94	0,24

(Source: Iberdrola, Analyst Estimates)

Each country is subjected to either different value drivers or to non-similar sources of risks

70%). The good positioning of Neoenergia matches with the high wind and hydro potential in the South American country. The company estimates investments totalling €265 Million in Elektro during the period 2012-2014 and the efficiency plan launched in 2012 is forecasted to minimize the impact of the tariff review positioning Elektro among the most efficient distributors within ANNEL's benchmarking for the next tariff review in 2015. In 2012, the estimated savings in operational expenditures will exceed the R\$ 35 Million forecasted objective reaching a value close to R\$ 40 Million. Neoenergia investment plan (distribution business) predicts an amount of €565 Million invested in the period 2012-2014. The upcoming project is estimated to increase the number of customers by approximately 866,000 and the energy distributed by 19%. Regarding the generation business, Neoenergia will invest €695 Million in the same period which includes the construction of new hydro plants (Teles Pires, Baixo Iguaçu, and Belo Monte) and wind farms forecasted to double the installed capacity (from 1,600 MW to 3,000 MW). For valuation purposes, we assumed an EBITDA Margin of 31,55% and a steady 26,8% NOE/GM ratio throughout the valuation which is in line with the company's expectations as well as represents the result of relevant efficiency improvements due the aforementioned efficiency plan launched by Iberdrola. Moreover, we considered an inflation rate of 4,5% in Brazil. Our estimations for CAPEX in the explicit period took into account not only the investment plan for the company for the 2012-2014 period and onwards but also the refurbishment costs associated to the depreciation of the Iberdrola's Brazilian assets. **Graph 11** and **Figure 18** represent our assumptions to the expected load factor for each technology and the total generation, respectively.

Valuation

The regulated business was evaluated based on a DCF method valuing separately each country. Even though they are engaged on the same business nature, each country is subjected to different value drivers and associated with different levels of risk and uncertainty. Expectedly, to reflect the opportunity cost

Exhibit 1: Regulated Activities Valuation

Sum-of-the Parts Valuation	Base Scenario (P=85%)		Worst Scenario (P=15%)		Expected Value		Weight in EV
	Fair Value	Per Share	Fair Value	Per Share	Fair Value	Per Share	
Network (Regulated)	38.866	6,33	29.051	4,73	37.394	6,09	50,9%
Spain	16.121	2,63	14.254	2,32	15.841	2,58	21,6%
UK	10.201	1,66	7.499	1,22	9.796	1,60	13,3%
US	6.915	1,13	4.271	0,70	6.518	1,06	8,9%
Brazil	5.629	0,92	3.026	0,49	5.239	0,85	7,1%

(Source: Analyst Estimates)

that investors face for investing their funds in one particular country/business instead of others with similar risk we discounted our forecast of FCF by a different WACC for each country in this segment. Within the same reasoning and

bearing in mind the inflation rate, we decided to establish different perpetual growth rates¹⁸. Through our analysis we reached a value of **€6.09** per share for the regulated segment. It represents the most important contributor to our Enterprise Value (EV), representing **50.9%** of it (see Exhibit 1).

Sensitivity Analysis

Exhibit 2: Revenue per unit distributed Vs Energy distributed

	Energy Distributed GWh					
	-10%	-5%	0%	5%	10%	
Revenue per unit distributed	-10%	6,03	6,03	6,04	6,05	6,05
	-5%	6,17	6,17	6,18	6,19	6,19
	0%	6,31	6,32	6,32	6,33	6,34
	5%	6,45	6,46	6,46	6,47	6,48
	10%	6,59	6,60	6,61	6,61	6,62

(Source: Analyst Estimates)

Exhibit 3: Actual Vanilla Return - Transmission Vs Distribution

	Actual Vanilla Return - Distribution (% Variation)					
	-30%	-15%	0%	15%	30%	
Actual Vanilla Return - Transmission (% Variation)	-30%	6,31	6,31	6,32	6,32	6,32
	-15%	6,31	6,31	6,32	6,32	6,33
	0%	6,31	6,31	6,32	6,32	6,33
	15%	6,31	6,32	6,32	6,32	6,33
	30%	6,31	6,32	6,32	6,33	6,33

(Source: Analyst Estimates)

Exhibit 4: Exchange Rate Sensitivity

Exchange Rate (% Variation from Base Case)								
-20%	-15%	-10%	-5%	0%	5%	10%	15%	20%
6,34	6,33	6,33	6,32	6,32	6,32	6,31	6,31	6,31

(Source: Analyst Estimates)

	WACC (% Variation)					
	-2%	-1%	0%	1%	2%	
Growth Rate (% Variation)	-2%	6,34	6,31	6,28	6,25	6,22
	-1%	6,36	6,33	6,30	6,27	6,24
	0%	6,39	6,35	6,32	6,29	6,26
	1%	6,42	6,38	6,34	6,31	6,28
	2%	6,45	6,40	6,37	6,33	6,30

(Source: Analyst Estimates)

Throughout our valuation we performed a sensitivity analysis for each segment in specific. Given the several key uncertainties inherent to any valuation, testing

multiple changes at a time would help to prioritize strategic fundamentals as well as to deepen the understanding offered by our valuation. A sensitivity analysis also helps bound valuation range when there is uncertainty about the inputs¹⁹. In what regards the regulated segment we decided to test how company's value in each country responds to changes in the key inputs. We firstly considered the energy distributed (GWh) and the revenue per unit distributed in Spain as the most significant variables to produce higher impact in our price

target. Even though the regulated nature of this business provides certain stability on earnings, the domestic business is especially relevant in this segment and therefore an overall change of the base scenario has a significant impact on the share price. Afterwards, since the regulatory return is especially relevant in UK (through the so-called RPI-X Price Control in which Ofgem regulates the price charged to the customers) we decided to test how changes in the actual vanilla

return on both businesses (distribution and transmission) would vary the actual price target of the company. Our analysis concluded that variations in those allowed returns would not change significantly the value of the company. In

this segment, the USD/EUR exchange rate is especially relevant as a significant part of cash flows is strongly reliant on future exchange rates (€/USD). An increase in the exchange rate implies an appreciation of the euro against dollar, and that leads to a decrease in the price target. As most of Iberdrola's regulated cash flows are denominated in Euros, potential fluctuations of the dollar are

¹⁸ Please consult "Sum-of-the-Parts" sections for more information on this issue

¹⁹ Koller, Goedhart and Wessels, *Valuation: Measuring and Managing the Value of Companies, 5th Edition, McKinsey & Company, Wiley Finance, 2010.*

partially offset and thereby the price target does not suffer a sharp decline. Finally, Brazil is seen as one of the main driver of future growth in the regulated sector. Therefore, most of its value comes from how growth in the future is perceived as well as how we discount those cash flows. So, it is important to access how target price changes as the terminal growth rate and WACC varies. We concluded that share prices may be between €6.22 and €6.45. Given the weight of the Brazilian assets, little change occurs to the fair value of Iberdrola.

Liberalized Business

Figure 19: Electricity Production in Iberia – ORP (TWh)

Market Share	2010	2011
Endesa	25%	30%
IBERDROLA	28%	25%
EDP/HC	17%	16%
Gas Natural Fenosa	17%	18%
Others	13%	11%

(Source: EDP)

The liberalized business includes the power generation (production of energy), and electricity and gas supply (selling of energy to liberalized customers). Since the 1st January 2011 the liberalized business in Iberia, UK, and Mexico has been integrated in a sole area with the aim of launching a new integrated management and to create a single business unit. This process integration has been created to create synergies, increase operational efficiency, and to optimize structures. The liberalized business represents the second most important contributor to our EV representing 25,4% of it.

Spain (Portugal): “Pressured by inefficient technologies”

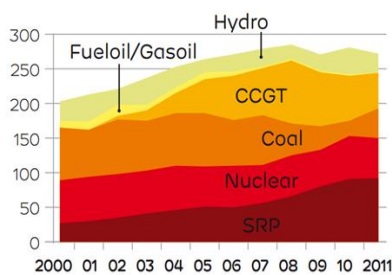
Figure 20: Electricity Free Retail in Iberia (TWh)

Market Share	2010	2011
Endesa	32%	33%
IBERDROLA	23%	23%
EDP/HC	15%	14%
Gas Natural Fenosa	15%	13%
Others	15%	16%

(Source: EDP)

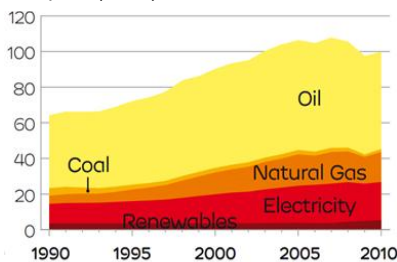
Iberdrola Spanish liberalized business (which includes also the activities in Portugal) encompasses either the liberalised generation (**see Figure 19**) or the supply activities (**see Figure 20**) of the company in Iberia. The first step towards liberalization was taken in 1995, with the publication of a legislation package to transpose Directive 96/92/CE of the European Parliament and Council, of 19th December 1996. Through the liberalization customers may get access to an increased competition in the market, reflected in the level of prices due operating efficiencies and improvements in the quality of the service, which should lead to greater satisfaction on the part of electricity consumers. The distinctive characteristics of the Spanish electricity sector comprise not only the fact that any consumer can freely choose its supplier since the 1st January 2003 but also the existence of the wholesale Spanish generation market (also referred to as the “Spanish pool”). Besides that, either bilateral contracts or the forward market have become a significant portion of the market. On the other hand, in Portugal since the 4th of September 2006, all consumers have been able to choose their electricity supplier. Generation facilities in Spain (**see Graph 10**) operate under either the Spanish Ordinary Regime or the Special Regime. The supply of electricity is fully liberalized in Spain since the 1st July 2009 and last resort suppliers, appointed by the Spanish government, supply electricity at a regulated tariff set by the Spanish government to the last resort consumers (low-voltage electricity consumers whose contracted power is less than or equal to 10KW). Up to that point, distributors were forbidden from supplying electricity to customers. Prices are then agreed between the final customers (**see Graph 11**) and the liberalized suppliers. The main source of operating expenses includes the wholesale market price and the regulated access tariffs (such as transmission, renewable, distribution energy subsidies, past tariff deficits, and others) to be paid to the distribution companies. As mentioned before, without participating in

Graph 10: Electricity Generation Mix – Spain (TWh)



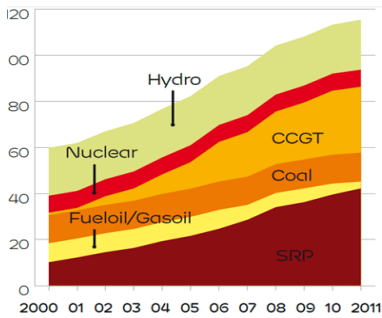
(Source: EDP)

Graph 11: Final Energy Consumption – Spain (Mtoe)



(Source: EDP)

Graph 12: Iberian Peninsula Installed Capacity 2011 (GWh)



(Source: EDP)

Figure 21: Installed Capacity (2011)

SPAIN	MW
Hydro	8,619
Nuclear	3,373
Coal	1,253
Fuel-Oil	157
Gas combined cycle	5,893
Cogeneration	405
TOTAL	19,700

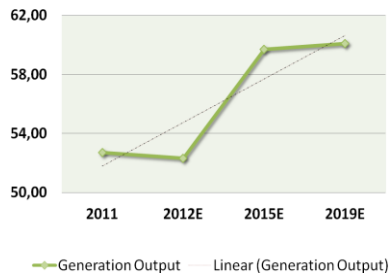
(Source: Iberdrola)

Graph 13: Estimated Prices (EUR/MWh) – Iberian Market



(Source: Iberdrola, Analyst Estimates)

Graph 14: Forecasted Generation Output (TWh)



(Source: Iberdrola, Analyst Estimates)

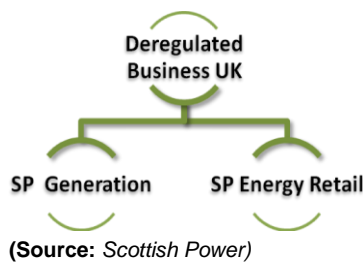
the wholesale market, bilateral contracts may also arise as a result of an agreement between electricity generators and liberalised suppliers or qualified consumers. In Spain (see Graph 12), the installed capacity of Iberdrola (excluding Renewables) amounted to 19,700 MW in the last year. Iberdrola presents a highly diversified energy mix and mostly constituted by low CO2 energies. Hydro and nuclear represents more than half of its portfolio (see Figure 21) which is a guarantee of very low generation operating costs for Iberdrola. Under the ordinary regime, the production totalled 50,026 GWh and the electrical energy supplied during 2011 on the free market amounted to 41,271 million kWh. During the last year, the company supplied 10,310 GWh of gas either to domestic or industrial customers. In Portugal, Iberdrola supplied 5,118 GWh in the last year, leading the market in Medium Voltage industrial customers and coming second in supplies to Small-Medium Enterprises. Concerning the regulatory framework, the so-awaited draft bill on environmental measures and energy sustainability (a bill containing tax provisions relating to energy generation and fuels) is estimated to produce a gross impact of €580 Million per year, in addition to the current tax burden of €330 Million, according to the company. Over the last couple of years, the business has been pressured by overcapacity of inefficient technologies (e.g. solar energies or national coal) and taxes. In the next years, the liberalized segment in Spain will be characterized by increased tax expenses, thermal gap decreasing (nevertheless almost all thermal capacity currently installed is required), and also a slow and gradual internalization of higher costs as well as an excess of offer. Commodity prices are also not offering a stable ground for the business since in the long-term no one can foresee accurately what we may expect. Regarding electricity business, we assumed the achieved price will behave in the long-term as presented in the Graph 13 as well as the forecasted market price and the access tariff. Along with the generation output (see Graph 14) and the electricity supply volumes, those represented the main inputs required to calculate the two major sources of revenues: power sales and supply business revenues. We considered a load factor of 90% in 2012 and 84% onwards in the case of nuclear. Concerning lignite, we assumed 14% in 2012, 19% in 2013 and 20% onwards while in the case of CCGT we assumed 22% in 2012, 27% in 2013 and 32% onwards. Finally, in the case of hydro we assumed 12% in 2012 and 18% onwards while assuming a 75,3% load factor in CHP. The steady NOE/GM ratio ranged from 27,2% to 26,5% in 2019 throughout our valuation model due high degree of efficiency after a redesign of commercial processes and IT investments and the EBITDA Margin was around 12% in the period. In the CAPEX projections, the investments in new hydro plans in Spain (La Muela or San Sebastian) were taken into consideration with the exception of CH Tamega in Portugal which is pending administrative process. For several

The current macroeconomic environment does not encourage such a huge investment

reasons we strongly believe this investment is not adequate given the current economic environment. Firstly, Portugal is experiencing a tough business environment. Secondly, the evolution of energy consumption (e.g. the electricity balance - hydro resources, under the ordinary or the special regime has gone down about 27% in the last year) in Portugal does not incentivize companies to engage on significant capital outflows. And finally, unless the Portuguese economy turns around faster than predicted the past business model for the hydro business is no longer sustainable.

UK: “Carbon tax poses a challenge”

Figure 22: Deregulated Business



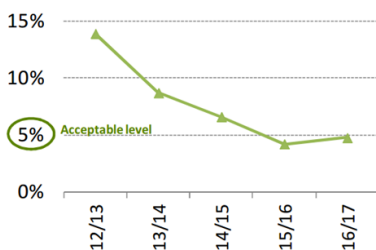
In the UK, the deregulated business is carried out by SP through the following asset management businesses (see Figure 22): SP Generation (within this division is SP Management, responsible for buying and selling wholesale energy), and SP Energy Retail (within this division is SP Dataserve, responsible for the metering and data management work). In its UK-liberalized business the installed capacity (excluding SPW Renewables) totalled 6,036 MW comprising coal, gas, pump storage and hydroelectric which provides to the business a diverse and flexible portfolio (see Figure 23). The production deriving from Iberdrola’s conventional generation was 20,584 GWh in 2011 and in the last year the company sold 22,019 GWh of electricity and 28,392 GWh of gas. The regulatory framework has been strongly pressured by the “carbon tax” by which its implementation is expected to impact the market equilibrium in the mid-term. From April 2013, a starting £4.94/MWh tax will be applied on CO2 emissions. Along with the “carbon tax”, market prices have already incorporated the higher costs of the marginal technology (CCGT) which will be taxed at £1.90/MWh and consequently coal-fired production competitiveness will rapidly deteriorate due to tax pressure on this technology. If there is no further capacity payments, 15,000 MWh of coal are 'at risk'. The only alternative to close during the 2016-20 period would be to lower the reserve margin²⁰ to undesired levels below the 5% acceptable rate (see Graph 15). However, the Department of Energy and Climate Change (DECC) is already reviewing a plan to run the legal framework for a capacity market in such a way that the first auction could potentially run in 2014 for capacity to be in place by 2015-16²¹. To offset the reduction in coal-fired capacity, Iberdrola is investing in the 389MW West of Duddon Sands wind farm with Denmark-based Dong Energy, a 217MW extension to the Whitelee wind farm, and 1,900 MW of CCGT capacities, including the 1,000 MW Damhead

Figure 23: Installed Capacity per technology

UNITED KINGDOM (SPW)	MW
Hydro	566
Coal	3,456
Gas combined cycle	1,914
Cogeneration	100
TOTAL	6,036

(Source: Iberdrola)

Graph 15: Reserve Margin – Scenario w/ Capacity Payments

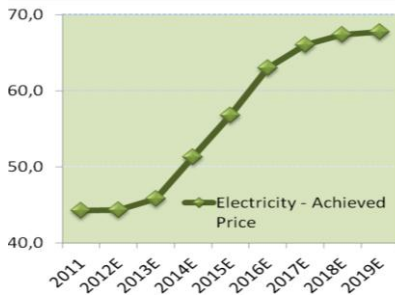


(Source: Iberdrola, Ofgem)

²⁰ Reserve Margin = Firm Capacity/Peak Demand. For instance, a reserve margin of 20% means that an electric system has excess capacity in the amount of 20% of expected peak demand

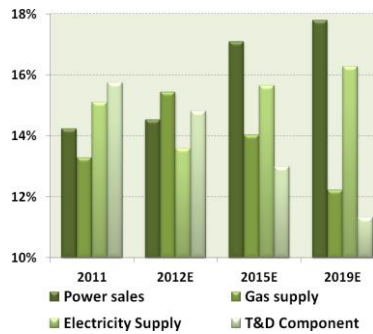
²¹ According to the European Directives, the regulator must clarify this regulatory uncertainty before December 2013 deadline

Graph 16: Electricity Selling Price



(Source: Analyst Estimates)

Graph 17: Main Revenue Contributors



(Source: Analyst Estimates)

Creek 2 project. In the short-term the company expect a reduced need for thermal gap. Nevertheless, a significant part of the installed capacity will disappear in the near term as a result of obsolete and novel environment regulation derived from the carbon floor effect²² that reduces future spreads and makes the extension of the useful life of said thermal facilities beyond 2018 challenging. On the other hand, the electricity market reform which aims at incentivizing major investments to replace the obsolete generation fleet, meet environmental goals and guarantee supplies is expected to represent a good opportunity for the generation business. Regarding the electricity supply, we assumed the electricity sold will remain almost steadily and the forecasted selling price as presented in the **Graph 16**. According to our projections, power sales and electricity supply will be the most important contributor to revenues (**see Graph 17**) in UK in the long-term representing together almost 35% of the overall revenues in 2019. For valuation purposes, we assumed a load factor of 40% in 2012 and 42,5% onwards in the case of Lignite. Concerning OCGT, we assumed 73% along the forecasting period while in the case of Hydro we assumed 13% in 2012 and 18% onwards. Finally, in the case of CHP we assumed 40% in 2012 and 50% thereafter.

Mexico: “Stable business – PPA Agreements”

In Latin America, Iberdrola is the leading private electricity producer in Mexico with an installed capacity of 4,968 MWh. The business is carried out through Iberdrola Mexico, a subsidiary of the Spanish Group Iberdrola dedicated to the generation and transmission of electricity. The electrical energy supplied was 37,002 GWh in 2011, 7% higher than the figure for the previous year. Iberdrola’s energy portfolio in this Latin American country is mostly based on thermal energy. Mexico presents a very stable business as most of the production is sold to Comisión Federal de Electricidad (CFE) under long-term contracts through Power Purchase Agreements (PPA) which involves a significantly lower risk. The availability has been maximising and is expected to be maintained in the next years. The current environment presents higher demand for electricity, higher competitiveness of gas versus other technologies, and competitive gas prices versus CFE tariff. The growth investment plan for the upcoming years will be based on short-term opportunities including the €90 Million expansion of the company's Enertek and Monterrey Cogeneration plants, as well as a new thermo plant being tendered by CFE in the 1st Quarter 2013. Iberdrola will also bet on enhancing efficiency management of energy surplus and improve efficiency as

Mexico – Very stable business as the bulk of its production is sold through PPA Agreements

Significant short-term opportunities are expected to arise

²² The carbon price floor was introduced by the British Government with the clear aim of providing certainty for low-carbon investment through a clear schedule of rising carbon prices, which will favor nuclear and renewable energy as well as gas.

Figure 24: Forecasted Generation

USD m/TWh	2011	2012E	2015E	2019E
Generation	12,68	13,31	15,37	16,14

(Source: Iberdrola, Analyst Estimates)

key measures to face the challenging environment under which Iberdrola will operate in the coming years in Mexico. For valuation purposes, we assumed a steady load factor of 82,5% for the upcoming years as a result of a potential capacity rounding 43,50 TWh (4966 MWh). The NOE/GM was around 19% throughout the explicit period. Finally, the EBITDA margin was assumed to have a steady continuously growing trend up to 2019, until it reached 27,68% from 27% in 2012. The forecasted generation is presented in the **Figure 24**.

Valuation

Once again, in our valuation for the deregulated business we applied a DCF approach. We decided to follow the same approach as previously done valuing each country separately using non-similar WACC and terminal growth rates for each country²³. The reasoning is very similar to the one presented in the segment before. We valued this segment in **€3.04** per share. The liberalized business represents the second most important contributor to our EV, representing **25.4%** of it (see **Exhibit 6**). Revising investment levels to the challenging environment

From selling to retail than in wholesale markets, Iberdrola has a competitive advantage

Exhibit 6: Liberalized activities valuation

Sum-of-the Parts Valuation	Base Scenario (P=85%)		Worst Scenario (P=15%)		Expected Value		Weight in EV
	Fair Value	Per Share	Fair Value	Per Share	Fair Value	Per Share	
Liberalized	20.665	3,37	7.272	1,18	18.656	3,04	25,4%
Spain	11.335	1,85	3.290	0,54	10.128	1,65	13,8%
UK	4.895	0,80	714	0,12	4.267	0,70	5,8%
Mexico	4.436	0,72	3.269	0,53	4.261	0,69	5,8%

(Source: Analyst Estimates)

under which Iberdrola is operating are expected to produce sustainable cash flows in the long-term. In the next years, we also expect Iberdrola to keep its competitive advantage from selling to retail than in wholesale markets due to the flexibility of its asset portfolio.

Sensitivity Analysis

Exhibit 7: Achieved Price in Spain Sensitivity

Achieved Price - Spain (% Variation from Base Case)				
-30%	-15%	0%	15%	30%
6,20	6,26	6,32	6,38	6,44

(Source: Analyst Estimates)

In the liberalized segment, we studied the impact of changes in achieved electricity prices either in Spain or in UK. This variable is essential to determine profitability and returns in those markets and during the last couple of years some relevant fluctuations in electricity prices have led Iberdrola to engage on hedging strategies to mitigate the uncertainty risk. Through this analysis we intend to access how value varies as those parameters changes. Comparing the **Exhibit 7** and **Exhibit 8**, we can easily conclude that Iberdrola is far more

Exhibit 8: Achieved Price in UK Sensitivity

Achieved Price - UK (% Variation from Base Case)				
-30%	-15%	0%	15%	30%
6,29	6,30	6,32	6,33	6,35

(Source: Analyst Estimates)

exposed to the domestic market than the UK market. Thereby, potential fluctuations in the main revenue drivers associated with the nature of this business

²³ Please consult "Sum-of-the-Parts" sections for more information on this issue

may impact our valuation in the long-term. As mentioned before, Mexico has represented a fairly stable business to Iberdrola since most of the value comes

Exhibit 9: Generation Output Sensitivity

Generation Output - Mexico (% Variation from Base Case)				
-30%	-15%	0%	15%	30%
6,31	6,31	6,32	6,32	6,33

(Source: Analyst Estimates)

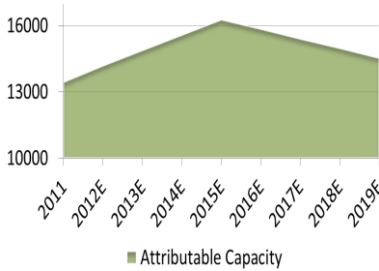
from the PPA agreements. However, it would be relevant to measure the impact of changes in the generation output (CCGT) in the actual price target. In line with our

expectations, potential changes in the production do not present a significant impact. Because of the smaller dimension of the deregulated segment in Iberdrola’s total value we may easily observe that changes in key drivers gives us a less broad range of different price targets (see Exhibit 9).

Renewable Business

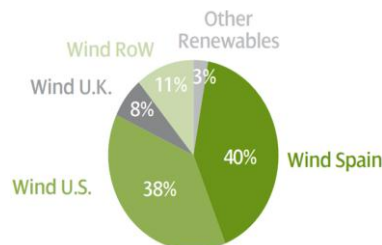
Renewables has experienced a huge growth in the past years

Figure 25: Forecasted Attributable Capacity (MWh)



(Source: Iberdrola, Analyst Estimates)

Graph 18: Installed Capacity by Region year ended 2011



(Source: Iberdrola)

The moratorium on renewable investments is seen as a non-positive catalyst for Iberdrola

The renewable segment includes either wind parks or energy from mini hydro and Gas & Thermal Technologies in the following countries: Spain, UK, USA and the rest of the world. We decided to include also the gas trading and storage businesses in the USA even though Iberdrola changed this segment into the deregulated section. Last year, Iberdrola launched a tender offer to buy back the shares it had sold before in order to get control of 100% of the company. After an astonishing investment amount in the period 2008-2010 with an average 1.7 GWh per year, the company entered in a new phase lowering its investment on new installations. During the period 2011-2012 the company established 2.1 GWh as the new target. Being the leader in world energy Iberdrola had an installed capacity of 13,690 MW having an operating capacity of 13,209 MW (see Figure 25), according to the operating data disclosed in the annual report 2011. The bulk of it was deployed in Spain and in USA. Following the process of geographic diversification outlined by the company to lower the exposure to its domestic business, more than 84% of the installed capacity in 2011 (1,158 MW) is already placed outside Spain. The company is expected to continuously increase its asset diversification which is in line with the approximately 57% of the total installed capacity already located abroad as the Graph 18 documents. The 2005-2009 period was characterized by a significant growth in the renewable sector especially in markets with growth potential such as Spain, USA and UK mostly due stable regulation and highly robust incentives. The upcoming years are expected to be a period of consolidation not only because economic crisis has impacted negatively prices and demand but also because in some important markets clarity on regulation is needed for 2012 onwards. Early in 2012 as Spain attempts to tackle surging budget deficits, more than twice as large as the legally allowable limit under EU law, the new Spanish Government decided to place a moratorium on new renewable energy investments. This situation has led to a

The decoupling of oil and gas or the Shale's increased stake in gas production pressured energy prices

In the next two years, Iberdrola will invest €2.6 Billion in its renewable activities

Figure 26: Expected Load Factor per technology

Load Factor	2011	2012	2016
Wind Spain	22%	24%	24%
Wind USA	31%	30%	30%
Wind UK	26%	25%	25%
Wind Others	22%	24%	27%
Minihydro Spain	25%	20%	22%
Thermosolar Spain	11%	16%	16%

(Source: Analyst Estimates)

We foresee Iberdrola still continuing its path of growth in renewable energy

dramatic reversal in the Spanish renewable energy industry, which was once one of the largest in Europe reducing long-term confidence in the stability of renewable energy policy. Markets such as Spain and UK are becoming less attractive and, in the next years, Iberdrola may be forced to look toward developing economies in Asia, Latin America and Africa expanding beyond the turbulent domestic business. In USA, along with Spain post 2013, regulatory framework is still pending increasing the regulation uncertainty. Furthermore, other recent developments of business fundamentals due to the macroeconomic crisis such as the decoupling of oil and gas or the Shale's increased stake in gas production well over the expectations has significantly pressured energy prices. Also, the company recently announced it will not invest anymore in the USA market if the production tax credit (PTC) is not renewed. In the UK, Enviro-Management & Research (EMR) post 2017 tariff framework is the single regulatory issue pending needed to be solved. In addition, the renewable obligation²⁴ is defined up to 2017. Iberdrola renewable business Investment Plan during the 2012-2014 period includes a total of €2.6 Billion, compared to €1.9 Billion spent annually between 2009 and 2011. Iberdrola is expected to slow down its investments in renewable energy as it seeks to shore-up its balance sheet, and concentrate on several key markets²⁵. The investment amount consists of €1 Billion in 2012, €800 Million invested in 2013 and the remaining €800 Million in 2014. During the aforementioned period Iberdrola will add 1.45 GWh of new wind power, of which 45% will be installed in the UK, 27% in Latin America and 14% each in Spain and the USA. Due the regulatory framework, investments involve completing projects that are already underway – there will be a moratorium on new investments in Spain. **The Figure 26** presents our assumptions regarding the load factor in each segment. We assumed the company will deploy 760 MWh in additional capacity in 2012 and 690 MWh per year in the period 2013-2015. In the remaining explicit period we assumed potential closures of 430 MWh per year resulting from the stagnation of the markets and stabilization of activities. For renewable investments, we assumed a benign regulatory framework, prompting investors to start pricing in a value for wind developer pipelines. As a result the EBITDA Margin ranged from 66% in 2012 reaching more than 70% in 2019.

Valuation

Our valuation over the renewable segment is based on a DCF model with a perpetual growth rate of 3% since we assumed Iberdrola's strategy and

²⁴ According to the Department of Energy & Climate Change: "Renewable obligation is currently the main financial mechanism by which the Government incentivizes the deployment of large-scale renewable electricity generation"

²⁵ Iberdrola Chairman Ignacio Galan said in its 3rd Quarter Presentation of Results

commitment to renewable energies would imply a future real growth²⁶. Even though most of the value coming from this segment is still very exposed to the Spanish market, Iberdrola intends to broad its activities in the UK and the rest of the world. If this runs to plan, we see significant upside potential in renewables.

Exhibit 10: Renewable Activities Valuation

Sum-of-the Parts Valuation	Base Scenario (P=85%)		Worst Scenario (P=15%)		Expected Value		Weight in EV
	Fair Value Per Share		Fair Value Per Share		Fair Value Per Share		
Renewable	17.829	2,90	5.341	0,87	15.956	2,60	21,7%

(Source: Analyst Estimates)

We valued this segment at **€2.60** per share. The renewable segment also represents an important contributor to our EV representing **21,7%** of it (see **Exhibit 10**).

Sensitivity Analysis

Concerning renewable activities, we identified the average load factor as one of the potential catalysts as well as, at the same time, a major source of uncertainty for this segment. The average load factor constitutes one of the most important

Exhibit 11: Load Factor in Spain Sensitivity

Load Factor - Spain (% Variation from Base Case)								
-60%	-45%	-30%	-15%	0%	15%	30%	45%	60%
6,25	6,26	6,28	6,30	6,32	6,34	6,35	6,38	6,40

(Source: Analyst Estimates)

efficiency ratios and plays a key role in determining the profitability per unit generated. We decided to test how the value of the company reacts to changes in the average load factor in Spain (see **Exhibit 11**) and USA (see **Exhibit 12**), as those countries represent the most significant portion of EBITDA to this segment. Expectedly, changes from the base case in Spain produces a higher impact on the value of the company as it represents the most significant value

Exhibit 12: Load Factor in USA Sensitivity

Load Factor - USA (% Variation from Base Case)								
-60%	-45%	-30%	-15%	0%	15%	30%	45%	60%
6,27	6,28	6,29	6,30	6,32	6,33	6,35	6,36	6,38

(Source: Analyst Estimates)

coming from renewable activities. As we have seen throughout several sensitivity analyses in each segment in specific, the price target has not been very impacted even when suffering relevant fluctuations on its main inputs. Obviously, the higher is the exposure to a given country or segment the more is Iberdrola subjected to relevant variations on the price target. However, we believe that the geographical diversification has been crucial to help Iberdrola on the process of mitigating some major sources of risks and uncertainties.

²⁶ Please consult "Sum-of-the-Parts" section for more information on this issue

Sum-of-the-Parts

The SOTP is the most suitable valuation approach in this case

Different businesses are subjected to non-similar drivers of value creation and risks

Our valuation of Iberdrola was run by applying the Sum-of-the-Parts (SOTP) analysis that provides a range of values for Iberdrola’s equity by summing the value of its individual business segments to arrive at the total EV. Equity value is afterwards calculated by removing net debt (includes interest bearing debt at market values) and other non-operating adjustments such as pension provisions or minorities. In our case we had to add up receivables related to the tariff deficit as we will explain later. Also, it is important to stress that the book value of interest bearing debt is reached under our expectations for assets and equity in the long-term and the market value of debt is then calculated taking into account the interest expenses and the average maturity of debt²⁷. We divided the company in its main areas, namely regulated segment (Spain, UK, USA and Brazil), liberalized business (Spain, UK and Mexico), renewables, other businesses, and other investments (holdings). For each area and country we constructed provisional maps, as the Balance Sheet, Income Statement and Statement of Cash Flows. Since the company has several different business segments involved on different macroeconomic scenarios subjected to non-similar sources of risks and growth prospects we strongly believe the SOTP method is the most suitable valuation approach. To further complement this analysis, we decided to formulate a worst case scenario in which we attempt to address the impact of a strong deterioration of the economy in Spain²⁸. Still, we analysed the problem of tariff deficit in detail in a different section since it represents one of the major risks for a Spanish utility company²⁹.

Figure 27: Valuation Approach

Segment	Valuation
Network (Regulated)	DCF
Spain	
UK	
US	
Brazil	
Liberalized	DCF
Spain	
UK	
Mexico	
Renewable	DCF
Other Businesses	EV/EBITDA FY12e
Holdings	Market Value

(Source: Analyst)

Valuation

We recommend buying Iberdrola given our FY13 target price of €6.32, corresponding to an overall return of 54% upon current price levels. For valuation purposes, we developed a DCF to value all the areas except other businesses and other investments in which we used a multiple approach and the market value for listed companies (see Appendix), respectively (see Figure 27). The valuation of each country and business segment was developed applying different criteria and assuming forecasts specifically for every situation. We used

$$^{27} \text{Market Value of Debt} = \text{Interest Expenses} \times \frac{1 - \frac{1}{(1+y)^F}}{y} + \frac{\text{Book Value of Debt}}{1+y}$$

²⁸ To further information please consult “Worst Case Scenario” later on this section

²⁹ To further information please consult “The Problem of Tariff Deficit” section in this report

a seven-year explicit forecast period (2013-2019) as well as a terminal value onwards. **The Exhibit 13** presents a summary of our valuation.

Exhibit 13: Fair Value of Iberdrola

Sum-of-the Parts Valuation	Base Scenario (P=85%)		Worst Scenario (P=15%)		Expected Value		Weight in EV
	Fair Value	Per Share	Fair Value	Per Share	Fair Value	Per Share	
Network (Regulated)	38.866	6,33	29.051	4,73	37.394	6,09	50,9%
Spain	16.121	2,63	14.254	2,32	15.841	2,58	21,6%
UK	10.201	1,66	7.499	1,22	9.796	1,60	13,3%
US	6.915	1,13	4.271	0,70	6.518	1,06	8,9%
Brazil	5.629	0,92	3.026	0,49	5.239	0,85	7,1%
Liberalized	20.665	3,37	7.272	1,18	18.656	3,04	25,4%
Spain	11.335	1,85	3.290	0,54	10.128	1,65	13,8%
UK	4.895	0,80	714	0,12	4.267	0,70	5,8%
Mexico	4.436	0,72	3.269	0,53	4.261	0,69	5,8%
Renewable	17.829	2,90	5.341	0,87	15.956	2,60	21,7%
Other Businesses	158	0,03	158	0,03	158	0,03	0,2%
Other Investments (Holdings)	900	0,15	900	0,15	900	0,15	1,2%
Total EV	78.419	12,77	45.325	7,38	73.455	11,97	
Net Debt	35.533	5,79	35.638	5,81	35.549	5,79	
Unfunded Pension Liabilities FY13e	1.435	0,23	1.374	0,22	1.426	0,23	
Minority Interests FY13e	320	0,05	320	0,05	320	0,05	
Tariff Deficit (Regulatory Receivables)	3.022	0,49	3.022	0,49	3.022	0,49	
Equity Value	44.153	7,19	11.015	1,37	39.182	6,32	

(Source: Analyst Estimates)

Figure 28: Forecasted WACC

WACC	%
Network (Regulated)	
Spain	6,49%
UK	5,48%
US	5,32%
Brazil	6,04%
Liberalized	
Spain	7,20%
UK	6,17%
Mexico	6,39%
Renewable	7,11%

(Source: Analyst Estimates)

Figure 29: Terminal Growth Rates

WACC	%
Network (Regulated)	
Spain	1%
UK	2%
US	2%
Brazil	4,5%
Liberalized	
Spain	1%
UK	2%
Mexico	2%
Renewable	3%

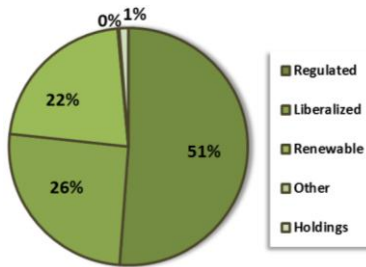
(Source: Analyst Estimates)

The WACC³⁰ (see Figure 28) used for the discount rate in each country or business area was developed to reflect the most significant risks in each macroeconomic scenario – the so-called systematic risk³¹. The FCFF are then discounted at the aforementioned cost of capital rate. As mentioned before, we attributed a terminal growth rate in each business area according to our perception of real growth for each activity (see Figure 29). Unlike the renewable sector in which we assumed future real growth, in every business area we applied a terminal growth rate in line with the inflation and GDP expectations implying that cash flows generated will stabilize in the future. According to our estimates, the regulated sector accounts for the largest proportion of the EV, followed by the liberalized segment and the renewable activities (see Graph 19). To estimate the risk-free rate we looked to government default-free bonds using highly liquid securities, such as the 10-year maturity bond. The 10-year German bund was the proxy used in European countries while the 10-year US Treasury bond was used in the USA as well as other American countries such as Brazil and Mexico. We also included a country risk premium which results from the difference between the local sovereign yield and the risk-free rates multiplied by

$$^{30} WACC = \frac{D}{D+E} \times rd \times (1-t) + \frac{E}{D+E} \times re$$

³¹ Under CAPM assumptions, only the systemic risk is relevant since everything else can be diversified. The required rate of return follows the expression: $E[Ri] = Rf + \beta i(E[Rm] - Rf)$, where Beta represents the systematic risk

Graph 19: EV by business



(Source: Analyst Estimates)

Figure 30: Cost of Debt

Current YTM	7,67%
Probability of Default	4,52%
Recovery Rate	70,73%
COST OF DEBT	7,57%

(Source: Analyst Estimates)

a volatility factor (ratio that relates equity with bonds volatility). Afterwards, sizing the difference between the market’s expected return and the risk-free rate is undoubtedly a non-consensual issue. In accordance with the financial literature³² the market risk premium was set at 5,80%. The Capital Asset Pricing Model (CAPM) was applied to estimate the cost of equity to every business segment. To calculate the average unlevered beta we selected a group of suitable industry-derived comparable companies in every single country/segment (see Appendix – every comparables used). We ran regressions using 3 years of monthly data against the S&P 500 Index. Then, we had to unlevered all betas considering the market capital structure of each company in specific since the computation of average unlevered betas removes the effects of financial leverage of the comparable firms. To obtain a beta for Iberdrola in every country inserted in a given segment, we averaged the betas and re-levered it afterwards towards a target debt-to-equity ratio, which we assumed to be each country or segment average. Regarding the cost of debt we applied an effective interest rate in accordance with financial literature³³ based on the market yield of comparable Iberian companies with similar rating and involved on the same industry and on the historical corporate defaults and recovery rates³⁴. We assumed Iberdrola’s market yield should be the average of those companies with similar rating.

Exhibit 14: Discount Rates and Terminal Growth

		Risk-Free	Country Risk	E [Rm]	Bu	D/E	Tax Rate	Bl	Cost of Equity	Cost of Debt	WACC	g
Regulated Business	Spain	2,21%	5,0%	5,80%	0,29	1,07	30%	0,51	7,76%	7,57%	6,49%	1%
	UK	2,21%	1,0%	5,80%	0,22	1,47	28%	0,45	5,30%	7,57%	5,48%	2%
	USA	2,36%	0,0%	5,80%	0,24	1,16	26%	0,45	4,98%	7,57%	5,32%	2%
	Brazil	2,36%	2,0%	5,80%	0,25	0,53	34%	0,33	6,59%	7,57%	6,04%	4,5%
Liberalized Business	Spain	2,21%	5,0%	5,80%	0,33	2,08	30%	0,81	11,14%	7,57%	7,20%	1%
	UK	2,21%	1,0%	5,80%	0,36	1,40	28%	0,73	7,18%	7,57%	6,17%	2%
	Mexico	2,36%	1,5%	5,80%	0,44	0,70	30%	0,66	7,16%	7,57%	6,39%	2%
Renewable Business	Renewable Business	2,28%	5,0%	5,80%	0,38	0,51	30%	0,52	8,04%	7,57%	7,11%	3%

(Source: Analyst Estimates)

Afterwards, the cost of debt incorporates a probability of default and recovery rates which are calculated based on the company rating³⁵ (see Figure 30). It is important to notice that the cash flows were converted based on forward exchange rates. In addition, these cash flows are presented in nominal terms, including inflation, which means that we used nominal discount rates. The summary of the main inputs used to value Iberdrola’s different activities are shown in the Exhibit 14. Last but not least, as mentioned before we used a

³² Pedro Santa-Clara and Shu Yan 2004 - “Jump and Volatility Risk Premia: A New Model and Lessons from S&P 500 options”

³³ Damodaran, A. 2010. “Valuation: Intrinsic, Relative and Contingent Claim Valuation”

³⁴ Moody’s Investors Service. February 2009. “Corporate Default and Recovery Rates, 1920-2008.”

³⁵ $Rd = y \times (1 - Pd) - (1 - RR) \times Pd$, where y represents the market yield, Pd stands for de probability of default and RR the recovery rate. Pd for Iberdrola is 4.52% given the probabilities associated with BBB and BB rated bonds. The recovery rate is 70.73% which constitutes a weighted average of the the recovery rate of bank loans and bonds.

The other businesses were valued based on a EV/EBITDA multiple of 7.2

multiple approach to value the other businesses. It encompasses the engineering and construction non-energy businesses through Ingeniería y Construcción and Inmobiliaria. Iberdrola. Ingeniería y Construcción is currently the world leader in the energy engineering sector and Iberdrola Inmobiliaria offers a large portfolio of products ranging from first homes to holiday homes, offices, factory premises and shopping centres. We applied a 7.2 EV/EBITDA FY12 multiple based on the average of comparable companies within the same industry.

Worst Case Scenario (15% Probability)

As mentioned throughout this report Spain has been strongly hit by an unprecedented sovereign debt crisis³⁶. Therefore, despite Iberdrola is even less exposed to its turbulent domestic business relying on its international activity worldwide, a relevant portion of its cash flows come from Spain. Due these major sources of risk surrounding the Spanish economy and the current economic outlook in Europe, we decided to include a worst case scenario in which the value drivers are valued assuming a much worse-than-expected evolution of its variables³⁷. We assumed the situation gets significantly worse affecting Iberdrola operational activity and for each business area we constructed a negative scenario. If Spain and the Euro zone fail to recover the confidence in the euro threatened by the high level of deficit and public sovereign debt that certain EU members display, this may lead to a decrease in GDP and inflation expectations as the domestic demand shrinks. Assuming a high level of contagion the remaining businesses not only in EU but also in the USA would be affected since the global economy is largely exposed to the European economy. So, in a context of a recession even growth prospects in Brazil or Mexico would be affected. After an idea about the macroeconomic impact on the main variables (see Figure 31), we addressed each segment separately. Since the regulated business represents a less volatile and very dependent on regulation, it would not suffer that much with the economic crisis even though we may argue that regulation would change³⁸. After that, the global macroeconomic environment would struggle to access for financing credit and liquidity. Some projects included in the 2012-2014 Investment Outlook would be postponed or cancelled affecting potential additional capacity on its available plants. In this context, the demand for energy would be increasingly reduced affecting the supply business. Consequently, the generation output would decrease in each production point as

One of the major uncertainties lies on the sustainability of the Euro Zone

Figure 31: Macroeconomic Impact

Macroeconomic Data	Spain	UK	USA	Rationale
Inflation	1%	1%	1%	Demand Shrinkage
GDP Expectations	Down	Down	Down	Domestic Production
Real Growth Rate Affected	Yes	Yes	Yes	Growth Prospects

(Source: Analyst)

Figure 32: Supply/Generation Impact

Liberalized Business	Spain	UK	Mexico	Rationale
Supply	Down	Down	Down	Energy Consumption
Generation	85% Base Levels	90% Base Levels	85% Base Levels	Production Shrinkage

(Source: Analyst)

³⁶ Government figures just released showed, for instance, that the jobless rate jumped to 25% in the third quarter of 2012 up from 24.6% in the second three months of the year

³⁷ In the worst case scenario we only change variables related with Iberdrola's businesses and macroeconomic data

³⁸ Assuming changes in regulation would be a quite unknown procedure as would be difficult to estimate either the relevant measures imposed by the Government or to forecast the impact on Iberdrola's earnings

Figure 33: *Impact on renewables*

Renewable Business	All areas	Rationale
Moratorium	Yes	Control deficit
Generation	85% Base Levels	Capacity Shrinkage

(Source: Analyst)

it would not make sense to produce at past demand levels and the load factor would immediately be lower (**see Figure 32**). Finally, the renewable business would experience a slowdown affecting its growth rate prospects as moratoriums for newly installed generators of renewable power may be renewed to reduce tariff deficits and adjust state expenses which would also reduce the production coming from renewable sources (**see Figure 33**). We attributed a probability of happening of 15% due growing concerns about the sustainability of the Euro Zone and the sovereign debt crisis.

Risk Factors

Regulation will be crucial to unlocking shareholder value

We identified several important main sources of risks to our thesis: the regulation, macroeconomic conditions, commodity prices, capital structure or shareholder ownership. As mentioned before regulation clarity plays a crucial role to unlocking shareholder value. We believe that more delays in the Spanish tariff deficit securitization may shrink its ability to deleveraging. Despite the better-than-expected measures announced by the Spanish government have partially removed the regulation uncertainty, Iberdrola is still very much exposed to regulatory risk not only in Spain but also in countries such as UK, US and Brazil.

The sovereign debt crisis produces significant risks

Secondly, the electricity sector might be substantially affected if extra measures are needed to solve the sovereign debt crisis reducing consumption levels. In June, Euro Zone leaders reached agreements about financial aid mechanisms to support the currency union avoiding the lack of demand for sovereign-bond issuances of peripheral economies. The most suitable path seems to be the consolidation plans and structural reforms already ongoing to assure that struggling economies may access the financial markets.

Fluctuations on commodity prices might affect earnings

Given the fact that a relevant part of Iberdrola's EBITDA comes from the fully liberalized business and the company is importantly exposed on the electricity and gas business in Spain or UK, commodity prices may also play a role on earnings and valuation as well. The last couple of years have been characterized by an extreme volatility in those prices given that lower demand and lower prices in some countries has significantly impacted earnings in the liberalized segment. Thereby, managing commodity prices risk incentivizing hedging strategies may be a key aspect to stabilize cash flows.

It is not fully unlikely selling part of its valuable Brazilian assets

In Brazil, Iberdrola has recently announced it is reviewing its strategy on Neoenergia and the decision on whether or not it plans to sell its stake in the company has not been taken yet. Like many other Spanish companies Iberdrola is struggling for raising cash to cut down its net debt and selling Brazilian assets is also an option. On the other hand, early in 2012 the company said do bid \$3.4 Billion to raise Neoenergia stake and therefore further acquisitions should be considered given the company's acquisitive history. At our valuation Iberdrola's stake in Neoenergia has remained constant to provide a realistic assumption. Iberdrola's current capital structure is cause for investor concern. The risk of needing to carry out a capital increase aggravated for Southern European utilities may be subjected to additional downsize risks. Moreover, either reduced availability of funds or higher financial burden would lower growth possibilities. Last but not least, further changes on the shareholder structure as explained before in the "Shareholder Structure" section, could have a negative impact on the share price.

There is also the risk of having to carry out a capital increase

The Problem of Tariff Deficit

Tariff deficit represents a major source of risk for Spanish utilities

Unlike Portugal, the tariff deficit in Spain has become a much serious problem

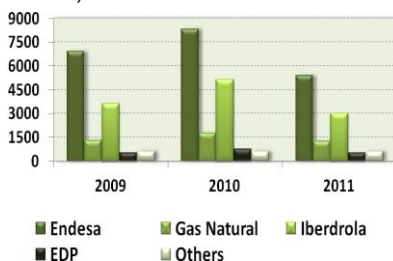
Specifically, regulation plays a very important role on accessing the value of an energy utility company being the following one of the key financial and business risks that Spanish utilities confront. During the last few years, power networks and renewable companies have substantially increased their costs of generating, transporting, distributing and supplying. However, tariff increases have remained limited leading to the creation of a €24 Billion tariff deficit (out of this amount, €17 Billion has already been securitized) putting pressure on the Spanish utilities as they have been financing the deficit before securitization occurs. The aforementioned difference between the real system costs and those recognized in the tariff has been funded in the balance sheet of the companies until it is settled being recognized as a receivable with a credit right to receive such amount with interests over 8 to 15 years³⁹. In May 2009, the Spanish Parliament passed a piece of legislation in order to change the financing system of the deficit by setting up a fund with issuances eligible to be explicitly guaranteed by the Kingdom of Spain. Consequently, the Electricity System Deficit Securitization Fund (FADE – Fondo de Amortización del Defice Eléctrico) was created to allow the electricity companies to sell over 5 years the tariff deficit receivables to the fund and to finance this transfer in the capital markets⁴⁰. At the time, the Spanish Government published a Royal Decree allowing the securitization of the deficit and preventing the creation of additional deficits from 2013 onwards. The securitization was consecutively postponed but, at the end of 2010, the CNMV finally passed it bringing hope to the sector. During 2011, FADE sold €8.5 Billion through five bond issues (see Figure 34) meaning that approximately 38% of the program was already completed. Expectedly, the pace of new issues is strongly affected by the evolution of the Spanish Government yield in the capital markets as these issues are guaranteed by the Kingdom of Spain. In addition, private placements were authorized by the Government since the last September which significantly eases the process providing flexibility and increasing the amount sold (for instance, in January this year the private placements totalled €447 Million). After the election of the new Government, there has been a strong discussion about this issue. Spanish Government has already implemented several measures to control and reduce the impact of the existing financial hole on the affected utilities balance sheet (Graph 20), such as the moratorium on renewable power. The Government decided to suspend the subsidies attributed

Figure 34: FADE issues during 2011

Issues	Month	Amount
1st Issue	January	€2 Billion
1st Issue	January	€2 Billion
1st Issue	January	€2 Billion
4th Issue	May	€1 Billion
5th Issue	September	€1.5 Billion
		€8.5 Billion

(Source: Iberdrola, Analyst Estimates)

Graph 20: Accumulated Tariff Deficit on company Balance Sheet (YE, € Million)

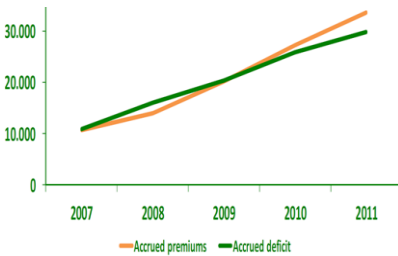


(Source: Iberdrola, Analyst Estimates)

³⁹ FADE Information Memorandum

⁴⁰ Additional Information: FADE is an open ended Fund which can buy Tariff Deficit Receivables and finance them by issuing Bonds with maturities ranging up to 15 years (Source: FADE Information Memorandum)

Graph 21: Tariff Deficit evolution (total recognized and Special Regime premiums (accrued Eur M)



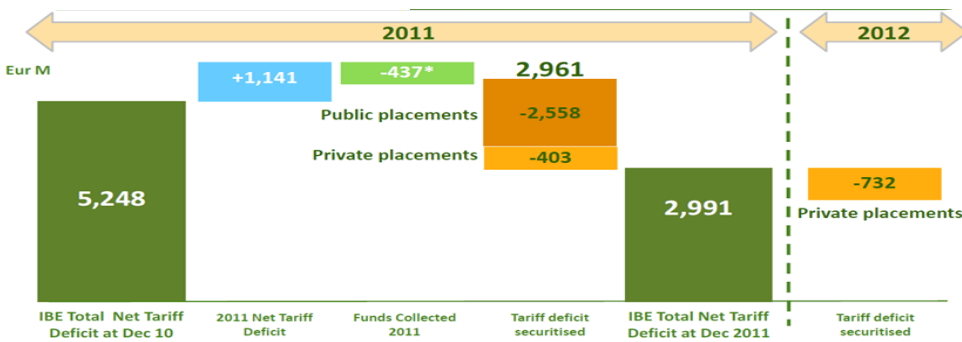
(Source: Iberdrola)

Figure 35: Theoretical Bill Breakdown (€ Billion)

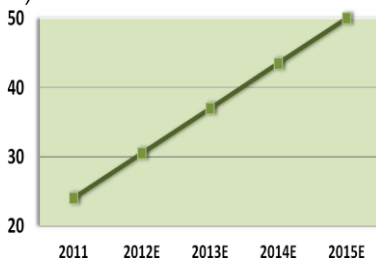
COST PER ITEM	AMOUNT
Generation Costs	14,70
Renewable Subsidies	7,60
T&D	6,90
Other	3,90
Theoretical Bill	33,10

(Source: Iberdrola, Analyst Estimates)

Exhibit 15: Iberdrola's Tariff Deficit



Graph 22: Forecasted tariff deficit without government intervention (Eur M)



(Source: Analyst Estimates)

to renewable technologies. However, this measure, seen as far from being operational, just alleviated the pressure over the tariff deficit as it just suspends the allocation of new remuneration rights to projects still pending official registration. According to Iberdrola, special regime premiums implies an annual cost of €250 per customer per year, which represents one of the highest in Europe due high tariffs given to solar technology that is still in a non-mature phase. Actually, **the Graph 21** shows that the tariff deficit is directly linked to the increase in renewable energy premiums. From being a measure to smooth tariff increases the tariff deficit is recently becoming a political tool. To give you an idea about the impact of such unbalance we decided to perform the following analysis. If we go back to the beginning of 2012 and imagine Spain as a utility company the cash bill covered by the tariff would represent an amount of €26.6 Billion. On the other hand, the theoretical tariff would reach a value of approximately €33.1 Billion (**see Figure 35**). Consequently, this unbalance would lead to the creation of a €6.5 Billion annual tariff deficit. Assuming a €6.5 Billion tariff deficit each year, without government intervention this value would reach an accumulated deficit of €50 Billion by 2016 (**see Graph 22**). Along with the deficit by itself, concerns about possible delays to the receipt of further proceeds in the electricity tariff deficit securitization have arisen given comments from the Minister of Industry that any securitization is unlikely in the near term. Thus, we are very cautious to include those proceeds from the securitization of Spanish tariff deficit receivables in our valuation as they are strongly dependent on credit market conditions as well. Tariff deficit has become for Iberdrola a structural problem with a significant increase from 2008. Thanks to €10 Billion of tariff deficit already placed by FADE in 2011 (€3 Billion) and €2.4 Billion in 2012 (€732 Million in a private placement), total securitizations amounted to more than €12 Billion (**see Exhibit 15**). Since there is no information available to determine if further securitizations will happen, we decided to assume the amount disclosed by the company on its presentation of results at the end of the 3rd quarter - €3.022 Billion. Last September, the Government announced the main highlights of a reform that should be effective as of January 2013. The fiscal measures wholly eliminated tariff deficit and thereby two important aspects has arisen: regulatory risk seems to go down as Government shows a constructive approach to the energy sector and balance sheet risk is significantly reduced as securitization of the outstanding regulatory receivable is more likely in the long-

run. In sum, the energy reform recently presented will allow the start of the restructuring.

Financials

According to our expectations, the renewable activities will represent the most dynamic activity while the regulated segment will continue to be extremely stable. The compounded annual growth rate (CAGR) will be approximately 6% (see **Figure 36**) and by 2019 renewable activities will already represent almost 25% of the EBITDA (see **Figure 37**), from the 19% accounted in the 2011 EBITDA. As mentioned earlier in this report, we foresee Iberdrola quite focusing on continuing its growth path in the renewable sector strengthening, at the same time, its networks business while the liberalized sector will continue to be the less attractive due its extreme volatility weakened by lower price and demand shrinkage in some countries. On the other hand, Iberdrola’s recently announced deleveraging programme reflects that the company wants to shore up its financial profile in a context of a weaker macroeconomic domestic environment and ongoing regulatory challenges in Spain. Not only Iberdrola but several utilities companies are showing commitment to deleveraging and improving its financial ratios which suggests it is a trend that is here to stay. Several measures were taken by Iberdrola to control its debt levels, namely the implementation of a lower CAPEX plan (the amount of investment in the renewable segment was largely

Figure 36: EBITDA CAGR (2012-2019)

EBITDA CAGR (2012-2019)	%
Regulated	4%
Liberalized	1,5%
Renewable	6%

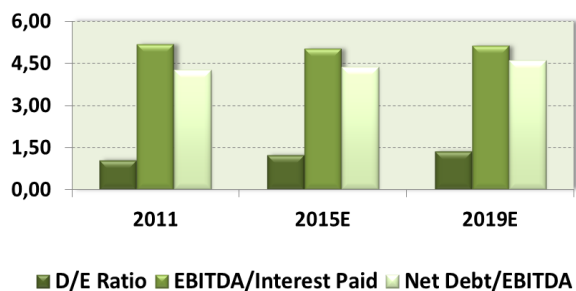
(Source: Analyst Estimates)

Figure 37: EBITDA 2019E share by segment

EBITDA by activity (2019)	%
Regulated	52%
Liberalized	25%
Renewable	23%

(Source: Analyst Estimates)

Exhibit 16: Financial Ratios Evolution



(Source: Analyst Estimates)

reduced last year) and the improvement of efficiency levels (Iberdrola is strongly committed to reduce its OPEX). **The Exhibit 16** shows that Iberdrola will be able to stabilize its financial ratios which are part of its financial strategy recently announced. In what regards Iberdrola’s credit rating, later in November S&P lowered its corporate credit rating on Iberdrola to 'BBB', and affirming their short-term rating at 'A-2'. They argued that potential delays in tariff deficit securitization and the difficult macroeconomic and business environment in its key markets may shrink its strategic focus on debt reduction. Despite we agree that eventual delays in the tariff deficit securitization and domestic turbulence may require downgrades in Iberdrola’s valuation, further geographical diversification, balance sheet restructuring, the sustainable generation of cash flows and its solid standing in credit markets will consolidate its advantage over its European peers (namely, EDP, RWE, ENEL or Centrica).

Appendix

Balance Sheet (Base Scenario)

Consolidated Balance Sheet (Eur M)	2011A	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Assets									
Non-Current Assets:									
Fixed Assets	73.202	74.133	76.691	79.287	81.878	84.147	86.270	88.296	90.205
Associates and Financial Investments	2.858	2.825	2.880	2.937	2.996	3.057	3.119	3.184	3.250
Deferred Tax Assets	4.545	3.328	3.443	3.539	3.670	3.775	3.807	3.929	4.036
Other Non-Current Assets	539	96	95	90	108	111	107	118	125
Total Non-Current Assets	81.144	80.382	83.109	85.853	88.652	91.090	93.304	95.527	97.615
Current Assets:									
Inventories	2.440	3.221	3.358	3.454	3.555	3.639	3.666	3.776	3.878
Current Trade and Other Receivables	5.365	7.214	7.520	7.735	7.962	8.150	8.211	8.457	8.686
Other Investments	4.876	4.832	4.937	5.044	5.155	5.268	5.384	5.502	5.624
Tax Receivables	857	910	946	985	1.027	1.060	1.067	1.103	1.129
Assets held for Sale	132	132	132	132	132	132	132	132	132
Cash & Cash Equivalents	2.091	2.274	2.370	2.438	2.509	2.569	2.588	2.665	2.737
Total Current Assets	15.761	18.583	19.263	19.788	20.339	20.818	21.047	21.636	22.186
Total Assets	96.905	98.965	102.372	105.641	108.991	111.908	114.351	117.163	119.802
Equity and Liabilities									
Equity									
Share capital	4.412	4.412	4.412	4.412	4.412	4.412	4.412	4.412	4.412
Unrealised Asset and Liability Revaluation Reserve	-386	-386	-386	-386	-386	-386	-386	-386	-386
Other Reserves	27.648	27.648	27.648	27.648	27.648	27.648	27.648	27.648	27.648
Treasury Shares	-384	-384	-384	-384	-384	-384	-384	-384	-384
Translation Differences	-1.207	-1.207	-1.207	-1.207	-1.207	-1.207	-1.207	-1.207	-1.207
Net Profit for the year	2.805	3.231	3.589	3.667	3.901	4.075	4.070	4.218	4.346
Equity Attributable to equity holders of the parent	32.888	33.314	33.672	33.750	33.984	34.159	34.153	34.301	34.430
Non-Controlling Interests	320	320	320	320	320	320	320	320	320
Total Equity	33.208	33.634	33.992	34.070	34.304	34.479	34.473	34.621	34.749
Liabilities									
Non-Current Liabilities:									
Bank Borrowings	30.454	30.773	32.732	34.923	37.168	39.123	41.346	42.976	44.578
Provisions	3.427	4.023	4.200	4.320	4.437	4.546	4.585	4.721	4.844
Deferred income and Other Payables	5.625	5.250	5.473	5.629	5.794	5.931	5.975	6.155	6.321
Deferred Tax Liabilities	9.742	10.088	10.515	10.816	11.133	11.397	11.482	11.826	12.146
Quasi-Equity Instruments	582	582	582	582	582	582	582	582	582
Total Non-Current Liabilities	49.830	50.717	53.502	56.270	59.114	61.579	63.970	66.259	68.470
Current Liabilities:									
Bank Borrowings	4.174	4.570	4.409	4.532	4.489	4.504	4.477	4.508	4.490
Provisions	573	940	980	1.008	1.037	1.062	1.070	1.102	1.132
Trade and Other Payables	9.121	9.104	9.489	9.760	10.046	10.285	10.361	10.672	10.960
Quasi-Equity Instruments		0	0	0	0	0	0	0	0
Total Current Liabilities	13.868	14.614	14.877	15.301	15.573	15.850	15.908	16.282	16.582
Total Liabilities	63.697	65.330	68.380	71.571	74.687	77.429	79.877	82.542	85.052
Total Equity and Liabilities	96.905	98.965	102.372	105.641	108.991	111.908	114.351	117.163	119.802
Interest Bearing Debt									
Net Debt	34.628	35.343	37.141	39.456	41.657	43.626	45.823	47.485	49.068
Net Debt	32.537	33.070	34.771	37.018	39.148	41.058	43.235	44.819	46.330
% Leverage	0,49	0,50	0,51	0,52	0,53	0,54	0,56	0,56	0,57
Capital Employed	67.835	68.978	71.133	73.526	75.962	78.105	80.296	82.106	83.817
Net Debt-to-EBITDA	4,25	4,11	4,12	4,28	4,31	4,37	4,55	4,57	4,61
Net Debt-to-Equity	0,98	0,98	1,02	1,09	1,14	1,19	1,25	1,29	1,33

(Source: Iberdrola, Analyst Estimates)

Income Statement (Base Scenario)

Consolidated Income Statement (Eur M)	2011A	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Revenues	31648	34412	35869	36895	37976	38877	39165	40340	41431
Procurements	-19622	-21945	-22737	-23389	-23913	-24377	-24559	-25318	-26126
Gross Profit	12026	12467	13132	13506	14063	14499	14606	15023	15305
Staff costs	-2151	-2262	-2374	-2455	-2527	-2588	-2601	-2672	-2708
Capitalised staff costs	508	493	515	531	548	561	565	579	585
Outside services	-2275	-2344	-2476	-2560	-2645	-2716	-2709	-2774	-2776
Other operating income	650	743	766	788	813	835	843	869	892
Other Operational Items	-3268	-3371	-3568	-3696	-3813	-3908	-3902	-3997	-4006
Taxes other than income tax	-1107	-979	-1029	-1064	-1071	-1084	-1097	-1124	-1154
EBITDA	7650	8037	8444	8652	9079	9403	9508	9803	10058
Amortisations and Provisions	3145	3169	3274	3377	3484	3577	3664	3749	3830
EBIT	4505	4868	5171	5275	5596	5826	5844	6054	6229
Financial Expenses	-2531	-2678	-2812	-2903	-3014	-3092	-3107	-3204	-3279
Financial Income	1469	1458	1531	1581	1642	1684	1692	1745	1786
Financial Result	-1062	-1220	-1281	-1322	-1373	-1408	-1415	-1459	-1493
Results of companies accounted by Equity Method	-35	-117	-119	-121	-123	-126	-129	-131	-133
Results from Non-Current Assets	46	255	411	423	435	445	448	461	473
PBT	3455	3785	4182	4255	4536	4738	4749	4925	5076
Corporate Taxes	-549	-841	-881	-875	-922	-950	-966	-994	-1017
Minorities	-101	287	287	287	287	287	287	287	287
Net Profit	2805	3231	3589	3667	3901	4075	4070	4218	4346

(Source: Iberdrola, Analyst Estimates)

Statement of Cash Flows (Base Scenario)

Consolidated Statement of Cash Flows (Eur M)	2011A	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
EBITDA	7651	8037	8444	8652	9079	9403	9508	9803	10058
D&A	3145	3169	3274	3377	3484	3577	3664	3749	3830
Net Financial Result	-1062	-1220	-1281	-1322	-1373	-1408	-1415	-1459	-1493
Interest Paid	-1481	-1611	-1692	-1747	-1814	-1860	-1869	-1928	-1973
Income from Group and Associates Companies	-35	-117	-119	-121	-123	-126	-129	-131	-133
Capital Gains/Losses	46	255	411	423	435	445	448	461	473
Earnings before Interest Paid and Taxes	4935	5397	5875	6002	6349	6598	6618	6853	7049
Taxes	784	1200	1237	1234	1290	1323	1346	1383	1412
Earnings before Interest Paid	4151	4197	4638	4767	5059	5275	5272	5470	5637
D&A	3145	3169	3274	3377	3484	3577	3664	3749	3830
Cash flows from Operating Activities	7296	7366	7911	8145	8543	8853	8936	9219	9467
Δ NWC	679	2700	93	78	84	68	18	82	68
Capex	7505	4100	5832	5973	6074	5847	5786	5776	5738
Other Assets	-577	-1737	275	256	318	281	207	315	301
Other Liabilities	1613	934	866	605	628	535	175	692	639
Cash flows from Investing Activities	5993	4129	5333	5702	5848	5661	5836	5481	5469
FCFF	1303	3237	2578	2442	2695	3192	3100	3738	3998
Interests Paid	-1481	-1611	-1692	-1747	-1814	-1860	-1869	-1928	-1973
Tax Shield	235	358	356	359	369	373	380	389	395
Changes in Net Debt	1303	533	1702	2247	2130	1909	2178	1584	1511
Change in Equity	-1361	-2517	-2944	-3302	-3380	-3614	-3788	-3783	-3931
Cash flows from Financing Activities	-1303	-3237	-2578	-2442	-2695	-3192	-3100	-3738	-3998

(Source: Iberdrola, Analyst Estimates)

Holdings

Holdings	Enterprise Value	Per Share	Valuation Method
Stake in EDP	571	0,09	Market Value
Stake in Gamesa	92	0,01	Market Value
Other Investments	237	0,04	Book Value YE2011
Total	900	0,15	

(Source: Iberdrola, Analyst Estimates)

Comparables

Cost of Equity - Iberdrola Comparables								
Company	Tkr & Exch	Country	Equity Beta	Market Capitalization	Debt	D/E	Tax Rate	Unlevered Beta
ENDESA SA	ELE SM	Spain	0,20	16749	13021	78%	30%	0,13
GAS NATURAL SDG SA	GAS SM	Spain	0,27	12068	21296	176%	30%	0,12
P G & E CORP	PCG US	USA	0,23	17496	13422	77%	26%	0,15
NATIONAL GRID PLC	NG/LN	UK	0,61	25194	24108	96%	28%	0,36
CENTRICA PLC	CNA LN	UK	0,28	16427	5730	35%	28%	0,22
EDP-ENERGIAS DE PORTUGAL SA	EDP PL	Portugal	0,76	7057	20646	293%	25%	0,24
GDF SUEZ	GSZ FP	France	0,61	39796	66157	166%	33%	0,29
SEMPRA ENERGY	SRE US	USA	0,41	12452	9697	78%	26%	0,26
TERNA SPA	TRN IM	Italy	0,47	5688	8204	144%	31%	0,24
CIA ENERGETICA DO CEARA-PR A	COCE5 BZ	Brazil	0,23	7141	6309	88%	34%	0,15
CIA ENERGETICA MINAS GER-PRF	CMIG4 BZ	Brazil	0,32	1003	405	40%	34%	0,25
CIA DISTRIBUIDORA DE GAS	CEGR3 BZ	Brazil	0,50	1267	186	15%	34%	0,46
ENERSIS SA	ENERSIS CI	Chile	0,19	8461	5704	67%	20%	0,12
EDP RENOVAVEIS SA	EDPR PL	Portugal	0,47	3250	4018	124%	25%	0,24
ACCIONA SA	ANA SM	Spain	0,83	2760	9323	338%	30%	0,25
SNAM SPA	SRG IM	Italy	0,68	11362	12455	110%	31%	0,39
ALPEK SA DE CV	ALPEKA MM	Mexico	0,89	72505	70885	98%	30%	0,53
COSAN LTD-CLASS A SHARES	CZZ US	Mexico	0,58	59058	39215	66%	30%	0,40

(Source: Bloomberg, Analyst Estimates)

Disclosures and Disclaimer

Research Recommendations

Buy	Expected total return (including dividends) of more than 15% over a 12-month period.
Hold	Expected total return (including dividends) between 0% and 15% over a 12-month period.
Sell	Expected negative total return (including dividends) over a 12-month period.

This report was prepared by a Masters in Finance student, following the Masters in Finance Equity Research – Field Lab Work Project, exclusively for academic purposes. Thus, the author, which is a Masters in Finance student, is the sole responsible for the information and estimates contained herein and for the opinions expressed, which reflect exclusively his/her own personal judgement. This report was supervised by professor Rosário André (registered with Comissão do Mercado de Valores Mobiliários as financial analyst) who revised the valuation methodology and the financial model. All opinions and estimates are subject to change without notice. NOVA SBE or its faculty accepts no responsibility whatsoever for the content of this report nor for any consequences of its use.

The information contained herein has been compiled by students from public sources believed to be reliable, but NOVA SBE or the students make no representation that it is accurate or complete, and accept no liability whatsoever for any direct or indirect loss resulting from the use of this report or its content.

The author hereby certifies that the views expressed in this report accurately reflect his/her personal opinion about the subject company and its securities. He/she has not received or been promised any direct or indirect compensation for expressing the opinions or recommendation included in this report.

The author of this report may have a position, or otherwise be interested, in transactions in securities which are directly or indirectly the subject of this report.

NOVA SBE may have received compensation from the subject company during the last 12 months related to its fund raising program. Nevertheless, no compensation eventually received by NOVA SBE is in any way related to or dependent on the opinions expressed in this report.

The Nova School of Business and Economics, though registered with Comissão do Mercado de Valores Mobiliários, does not deal for or otherwise offers any investment or intermediation services to market counterparties, private or intermediate customers.

This report may not be reproduced, distributed or published without the explicit previous consent of its author, unless when used by NOVA SBE for academic purposes only. At any time, NOVA SBE may decide to suspend this report reproduction or distribution without further notice.