

Energy

Sector Review – September & October

1. Sector Overview

- With profit margins of oil refining decreasing due to overcapacity in Europe, where demand has been falling, and political tensions in oil and gas producing countries, production has fallen worldwide. This context assists in explaining the poor performance of most companies in the sector, reflected by the earnings announcements for the third quarter.
- In September, the oil market was still suffering from the consequences of the political tensions in Lybia and Syria and the decrease of production in Nigeria. Prices were pushed to a six-months high by the end of August. In October, oil prices have shown a downward trend, namely due to the reported increases in oil supply by the US Government.
- After strengthening its position in the Canadian, Middle Eastern and European firms, namely through the acquisition of a 21% stake in EDP, Chinese companies in the energy sector focused on Brazil by joining a consortium to acquire Libra's oil field, Rio de Janeiro, the largest to be sold in 2013.
- In Portugal, oil and natural gas consumption have fallen 8.6% and 8%, respectively, in comparison to the same period of 2012. Electricity production from renewable sources has increased 27% since August 2012, mainly due to hydro energy. Coal consumption has decreased by 14%, due to lower usage of thermal power generation plants.
- Due to the decrease of costs of land-based installations, wind power is now expected to be able to guarantee 15% to 18% of total electricity in 2050, 3% to 5% more than previous predictions.



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Energy Universe:

- EDP
- Endesa
- GALP
- Royal Dutch Shell
- Vestas

This month's detailed company review:

- EDP



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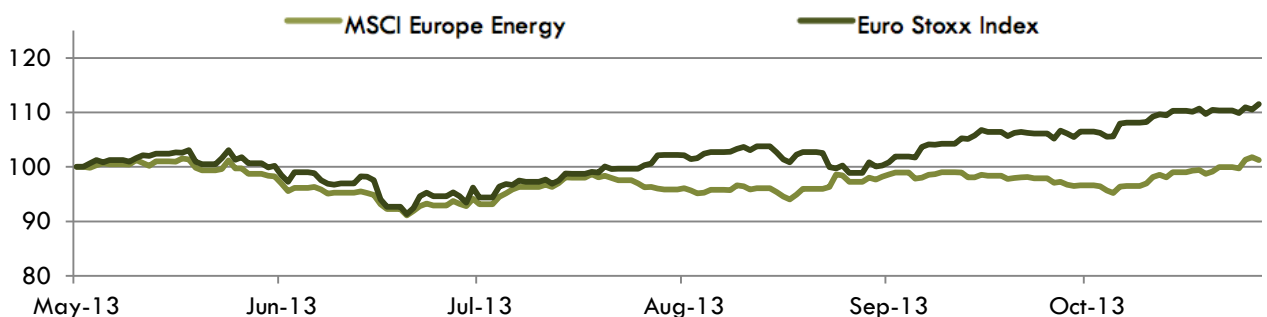
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Table of Contents

1. Sector Overview
2. Universe News
3. Detailed review: EDP

Energy Sector vs. Overall market



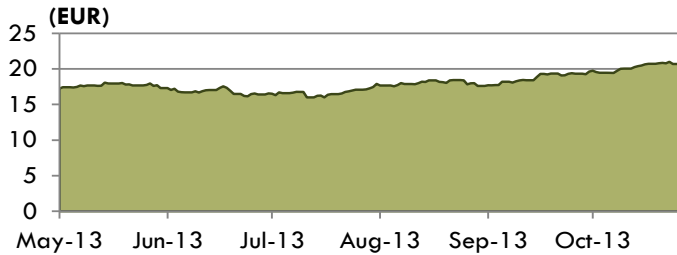
- The Morgan Stanley Capital International for Europe Energy (MSCI) clearly underperformed in comparison with the most suited market index for this comparison, the Euro Stoxx Index. While Euro Stoxx had a 11.54% growth rate from May to October 2013, MSCI Europe Energy grew only 1.29%, hence being close to flat in the timeframe considered. The Euro Stoxx Index displayed a clear upward trend since late August 2013, when the gap between the two indexes became increasingly clearer.

2. Followed Companies

ENDESA

(Ticker: ELE SM)

- Iberian poor performance in the first semester of 2013 has been partially compensated by the firm's results in Latin America, which increased more than 50% in one year. Focus on the region is expected to be maintained, namely due to a 19% increase in investment in generation since 2012.

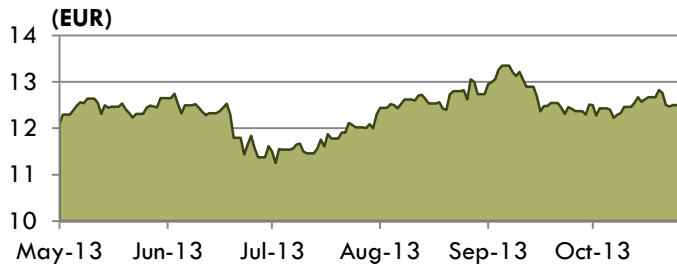


Price (EUR):	↓	20.70
Target Price (EUR):		19.10
Up/downside:		-7.7%
Performance 3M:		21.2%
P/E Ratio:		11.5x
ROC/WACC:		0.8x

GALP

(Ticker: GALP PL)

- Net income on 2013's third quarter was 40% lower than in the same period of 2012. This disappointing result was mainly a consequence of amortizations and a decrease in profitability of refining. The firm's continued effort to diversify its implementation maintains Brazil as one of the firm's main focus in 2013.

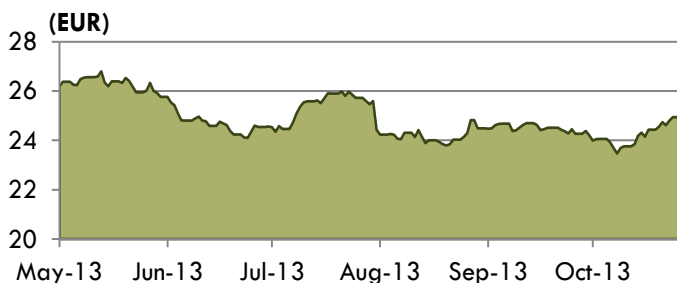


Price (EUR):	↑	12.46
Target Price (EUR):		15.50
Up/downside:		24.4%
Performance 3M:		3.7%
P/E Ratio:		62.5x
ROC/WACC:		0.2x

Royal Dutch Shell

(Ticker: RDSA LN)

- Earnings for the third quarter were USD 4.2 billion, USD 2 billion less than in the same period of 2012. In October, Shell became the holder of 20% of a consortium which gained the right to explore Libra, in Brazil, the most important oil prospect to be sold this year. Oil reserves in this field are predicted to be of more than 8 million barrels – more than US consumption in 2012.

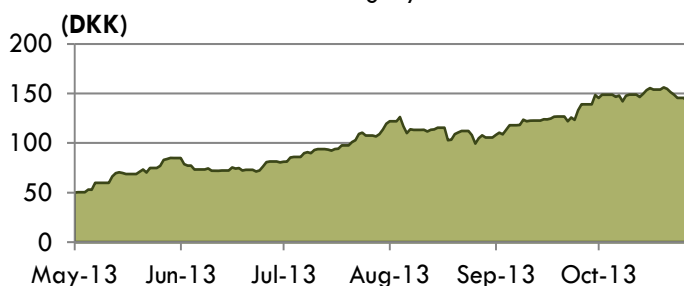


Price (EUR):	↑	25.01
Target Price (EUR):		27.13
Up/downside:		8.5%
Performance 3M:		-2.8%
P/E Ratio:		9.9x
ROC/WACC:		1.1x

Vestas

(Ticker: VWS DC)

- Due to overcapacity among turbine producers, lower demand and lack of government incentives in renewable energy, Vestas sold six production units expecting to save EUR 30 million. The firm joined Mitsubishi in a joint venture for investment in offshore wind turbines and has also gained 51MW and 108MW orders from Uruguay and Romania.



Price (DKK):	→	138.60
Target Price (DKK):		142.50
Up/downside:		2.8%
Performance 3M:		28.8%
P/E Ratio:		N/A
ROC/WACC:		-2.0x

3. Stock Analysis: EDP

Corporate News

▪ The firm's investment in Brazil has been increasing, with production in the country surpassing 2,100MW. Future productive capacity will be added with the conclusion of a R 1.1 billion investment in an hydro electric production plant which began construction in October. EDP is also investing in wind power generation in Brazil, with an on-going project for a 120MW wind-turbine park in Rio Grande do Norte, to begin operations in 2016.

▪ EDP's results for 2013 first nine months were almost unchanged in comparison with the same period of 2012. Earnings decreased less than 0.5%, to EUR 792 million. EBITDA increased 2%.

Market Performance

▪ The firm's issue of EUR 750 million worth of corporate bonds with maturity in 2020 and a coupon rate of 4.875% was followed by the placement of its credit rating on CreditWatch by Standard&Poors, with a negative outlook, mirroring that of the Portuguese Republic.

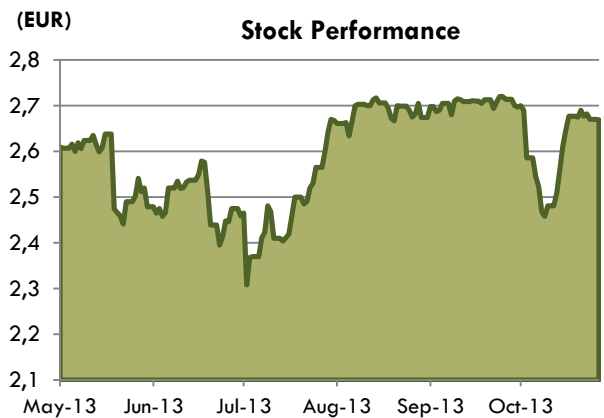
▪ Currently, EDP trades at EUR 2.669, slightly below the target price. This might indicate that the stock is currently undervalued.

Valuation Summary

▪ Looking at the valuation multiples, one can see that, similarly to the stock target price, some of them (trading ones) suggest an undervaluation of the stock price even though it is small. However, the transaction multiples suggest the opposite conclusion, that is the stock being overvalued.

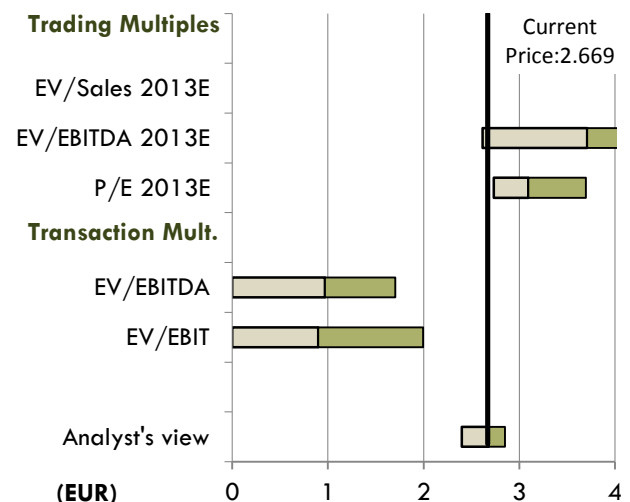
▪ The EV/EBIT transaction multiple is the one suggesting the biggest discrepancy to current price, as it suggests a median fair value farther from EDP's current stock price.

▪ Analysts' expectations suggest the fairest valuation of the stock price, with a target price of EUR 2,67 which is extremely close to the current price.



EDP (EUR)	
Current Price (28/10/2013)	2.669
52-week high % change	-2.8%
Median Target Price	2.67
Market Capitalisation (mn)	9,895
Return on Common Equity	12.2%
Dividend Yield	6.8%
Beta (vs. S&P500)	0.9x
Total Debt/Equity	179.5%

Valuation Summary (Price per Share)



Comparable Analysis

Company Name	Currency	MCap (mn)	Enterprise Value (mn)	EV/Sales			EV/EBITDA			P/E		
				LTM	2013E	2014E	LTM	2013E	2014E	LTM	2013E	2014E
EDP	EUR	9.909	31.217	1,9x	2,0x	2,0x	8,6x	8,5x	8,5x	10,0x	9,9x	10,7x
RENE	EUR	1.196	3.806	6,5x	4,6x	4,6x	7,5x	7,5x	7,6x	10,3x	10,0x	9,9x
SNAM	EUR	12.728	25.606	6,7x	7,2x	7,0x	8,9x	9,2x	9,1x	13,4x	13,8x	13,1x
RWE	EUR	16.848	37.537	0,7x	0,7x	0,7x	3,5x	4,2x	4,8x	11,6x	7,0x	9,8x
REE	EUR	6.257	11.757	N.A.	6,7x	6,5x	8,9x	9,1x	8,8x	24,5x	12,5x	12,3x
TRN	EUR	7.393	14.455	7,5x	7,7x	7,7x	10,1x	9,9x	9,8x	14,6x	15,0x	14,8x
75th Percentile				6,7x	7,0x	6,9x	8,9x	9,2x	9,0x	14,3x	13,5x	12,9x
Median				6,5x	5,6x	5,5x	8,8x	8,8x	8,7x	12,5x	11,3x	11,5x
25th Percentile				1,9x	2,6x	2,6x	7,8x	7,7x	7,8x	10,6x	10,0x	10,1x

- In terms of comparable listed companies, EDP appears to be undervalued, as the company trades 8.5x EV/EBITDA and 9.9x P/E for 2013E, contrasting with the industry peers, which are trading at a median 2013E EV/EBITDA and P/E of 8.8x and 11.3x, respectively.
- The most comparable company in terms of market capitalization is Terna (TRN), the Italian firm that controls a substantial portion of the national electric supply. Terna is trading at a EV/Sales 2013E of 7.7x, therefore above EDP, and at 2013E EV/EBITDA and P/E of 9.9x and 15.0x, respectively, also above EDP's figures. The fact that all multiples are higher than the industry median might indicate that Terna is overvalued.

Precedent Transactions

Announced Date	Target		Buyer		TV		
	Company	Country	Company	Country	(EUR mn)	TV/EBITda	TV/EBIT
31-Oct-13	Alliance Oil Co Ltd	SS	Alliance Group OJSC	UZ	2162.05	5.5x	7.9x
22-Oct-12	Rosneft OAO	RU	BP PLC	GB	3674.00	4.5x	7.0x
30-May-12	Snam SpA	IM	Cassa Depositi e Prestiti SpA	IM	3517.00	4.4x	5.9x
17-Oct-11	Brigham Exploration Co	US	Statoil ASA	NO	3296.47	14.3x	20.5x
04-Aug-11	EDF Energies Nouvelles SA	FP	Electricite de France SA	FP	5491.23	15.3x	22.9x
07-Feb-11	Pride International Inc	US	Enesco PLC	US	6248.73	18.4x	30.7x
24-Jun-09	Addax Petroleum Corp	CN	China Petrochemical Corp	CH	6311.65	3.2x	4.1x
75th Percentile						16.0x	2.0x
Median						13.9x	1.6x
25th Percentile						11.7x	1.4x

- When looking at various precedent transactions in the sector over the last five years, the most popular one was the transaction between BP and Rosneft in late 2012; the Russian integrated Oil&Gas giant was valued at an TV/EBITDA of 4.5x and TV/EBIT of 7.0x.
- Another interesting transaction occurred between Eni and Cassa Depositi e Prestiti. A 30% stake in Snam, the Italian natural-gas distributor with a market cap similar to EDP's, was sold by the energy giant in Italy to a national state bank. The valuation of 4.4x TV/EBITDA and 5.9x TV/EBIT were, respectively below and above the market, where transactions occurred at a median 13.9x EV/EBITDA and the median EV/EBIT being 1.6x.