

ERG

Italy | Utilities | MCAP EUR 2.4bn

16 May 2019

Buy (Hold)

Target Price	EUR 18.00 (18.00)
Current Price	EUR 16.27
Up/downside	10.6%
Change in TP	none
Change in EPS	-0.3% 19E / 5.9% 20E

Upgrade to Buy after negative performance

On the same equity story, with its business plan on track, guidance confirmed and (probably) mostly due to a transitional weakness as a result of low hydroelectric production, ERG's share price performance has been weak (-21% 1Y, -4% 6M, -3% 3M). On a EUR18 (confirmed TP), we now have an appealing upside potential of 11% and a 4.6% dividend yield (DPS ex-date is 20 May). We upgrade our rating from Hold to Buy.

Equity story intact

ERG is the successful transformation story of an oil company into a renewable utility. In Q1 2019, its installed capacity reached 3GW, of which 1.8GW from wind (1.1GW in Italy), 527MW from hydroelectric generation (central Italy), 480MW from one CCGT in Sicily, and 141MW from solar plants (Italy). In 2019E, 55% of its EBITDA could come from wind power generation and 23% from hydroelectric generation. Regional diversification has just begun and is likely to continue given the company's firepower and successful historical growth path. Technological diversification is ongoing, with the acquisition (in 2018-19) of 141MW of solar plants in Italy.

Business plan accelerated

The company's target is to reach 3.6GW of installed capacity in 2022, from its current 3GW. All in all, according to the plan presented in March 2018, EBITDA could reach EUR500m in 2020 (KECH EUR520m) and EUR560m in 2022, of which EUR347m from wind, EUR123m from hydroelectric generation, EUR34m from CCGT, and EUR56m from solar. Net debt/EBITDA could reach 2.1x in 2022. The dividend policy is based on a minimum DPS of EUR0.75. Guidance for 2019 is as follows: EBITDA of EUR495-515m (KECH: EUR516m), net debt of EUR1.36-1.44bn (before EUR65m from IFRS 16 impact), and of EUR340-370m after capex, and a DPS of EUR0.75 (KECH is in line). This 2019 guidance was confirmed after the Q1 2019 results.

Valuation confirmed

We confirm our EUR18 TP, based on our SOP valuation, in which we run DCFs (WACC 7%) for the main business units (wind, thermoelectric and hydroelectric), while we use the acquisition price for the solar business. We also add EUR208m (8% of our TP) to reflect the further equity value that should come from the full implementation of the business plan.

Claudia Introvigne

Equity Research Analyst

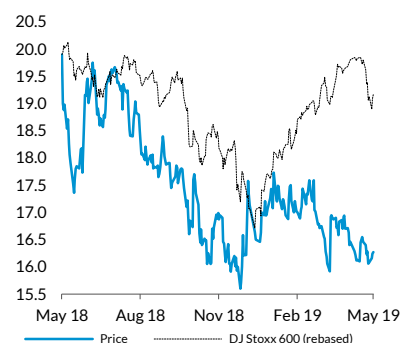
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Market data

Bloomberg: ERG IM	Reuters: ERG.MI
Market cap (EURm)	2,446
Free float	37%
No. of shares outstanding (m)	150
Avg. daily volume (EURm)	7.2
YTD abs performance	-1.4%
52-week high/low (EUR)	19.75/15.60

FY to 31/12 (EUR)	12/19E	12/20E	12/21E
Sales (m)	1,075.0	1,078.2	1,065.2
EBITDA adj (m)	516.2	519.9	512.2
EBIT adj (m)	232.8	237.4	229.7
Net profit adj (m)	116.7	118.9	119.5
Net debt (m)	1,483.4	1,381.6	1,136.4
FCF (m)	243.5	259.0	212.5
EPS adj. and fully dil.	0.78	0.79	0.80
Consensus EPS	0.79	0.86	na
Net dividend	0.75	0.75	0.75

FY to 31/12 (EUR)	12/19E	12/20E	12/21E
P/E adj and ful. dil.	20.9	20.6	20.5
EV/EBITDA	7.4	7.2	6.8
EV/EBIT	16.5	15.7	15.2
FCF yield	9.5%	10.1%	8.3%
Dividend yield	4.6%	4.6%	4.6%
Net debt/EBITDA	2.9	2.7	2.2
Gearing	109.2%	100.8%	82.1%
ROIC	5.9%	5.9%	6.1%
EV/IC	1.3	1.3	1.4



Key financials

FY to 31/12 (EUR)	12/14	12/15	12/16	12/17	12/18	12/19E	12/20E	12/21E
Income Statement (EURm)								
Sales	1,998.8	937.3	1,025.0	1,035.6	1,049.5	1,075.0	1,078.2	1,065.2
% Change	-71.7%	-53.1%	9.4%	1.0%	1.3%	2.4%	0.3%	-1.2%
EBITDA adjusted	490.7	350.0	456.0	472.0	496.5	516.2	519.9	512.2
EBITDA margin (%)	24.5%	37.3%	44.5%	45.6%	47.3%	48.0%	48.2%	48.1%
EBIT adjusted	249.2	179.0	202.0	220.5	221.0	232.8	237.4	229.7
EBIT margin (%)	12.5%	19.1%	19.7%	21.3%	21.1%	21.7%	22.0%	21.6%
Net financial items & associates	-131.0	-109.0	-46.2	-43.0	-70.0	-70.6	-71.6	-62.9
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tax	-155.7	-12.6	-28.7	-36.0	-39.0	-47.9	-49.0	-49.2
Net profit from continuing operations	73.4	23.4	125.1	141.5	106.8	117.2	119.9	120.6
Net profit from discontinuing activities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net profit before minorities	73.4	23.4	125.1	141.5	106.8	117.2	119.9	120.6
Net profit reported	48.5	20.3	122.7	141.5	106.7	116.7	118.9	119.5
Net profit adjusted	76.0	96.3	122.7	141.5	106.7	116.7	118.9	119.5
Cash Flow Statement (EURm)								
Cash flow from operating activities	350.1	165.1	428.3	410.0	363.4	390.5	398.4	401.9
Capex	-55.9	-261.1	-369.7	-44.2	-44.2	-147.0	-139.4	-189.5
Free cash flow	294.2	-96.0	58.6	365.8	319.2	243.5	259.0	212.5
Acquisitions & Divestments	330.0	-950.0	0.0	31.0	-162.9	-221.0	0.0	0.0
Dividend paid	-71.4	-71.4	-142.8	-71.4	-164.2	-107.1	-107.1	-107.1
Others	-75.1	0.7	-26.1	0.0	-102.8	7.6	-50.1	139.9
Change in net financial debt	477.7	-1,116.7	-110.3	325.4	-110.7	-76.9	101.8	245.3
Balance Sheet (EURm)								
Intangible assets	801.1	707.4	701.1	701.1	701.1	701.1	701.1	701.1
Tangible assets	1,366.3	2,414.3	2,531.0	2,292.7	2,327.8	2,471.7	2,381.8	2,151.9
Financial & other non-current assets	156.3	102.1	139.8	162.8	162.8	162.8	162.8	162.8
Total shareholders' equity	1,718.9	1,676.0	1,729.4	1,853.5	1,632.9	1,358.0	1,370.8	1,384.2
Pension provisions	4.7	4.8	4.9	5.0	5.1	5.2	5.3	5.4
Liabilities and provisions	2,456.9	2,676.4	2,535.8	2,188.1	2,467.5	2,891.7	2,789.5	2,543.3
Net debt	330.2	1,446.9	1,557.2	1,231.8	1,342.5	1,483.4	1,381.6	1,136.4
Net financial debt	330.2	1,446.9	1,557.2	1,231.8	1,342.5	1,483.4	1,381.6	1,136.4
IFRS 16 debt	0.0	0.0	0.0	0.0	0.0	64.0	64.0	64.0
Working capital requirement	106.4	311.0	246.6	260.6	278.8	286.0	286.9	285.0
Invested Capital	1,598.1	2,850.8	2,903.1	2,678.8	2,732.1	2,883.2	2,794.2	2,562.4
Per share data								
EPS adjusted	0.51	0.64	0.82	0.94	0.71	0.78	0.79	0.80
EPS adj and fully diluted	0.51	0.64	0.82	0.94	0.71	0.78	0.79	0.80
% Change	100.0%	26.7%	27.4%	15.3%	-24.6%	9.4%	1.8%	0.6%
EPS reported	0.32	0.14	0.82	0.94	0.71	0.78	0.79	0.80
Cash flow per share	2.33	1.10	2.85	2.73	2.42	2.60	2.65	2.67
Book value per share	11.12	10.82	11.50	12.33	10.86	9.03	9.11	9.19
Dividend per share	0.50	1.00	0.50	1.15	0.75	0.75	0.75	0.75
Number of shares, YE (m)	150.32	150.32	150.32	150.32	150.32	150.32	150.32	150.32
Ratios								
ROE (%)	4.4%	5.8%	7.3%	7.9%	6.1%	7.8%	8.7%	8.7%
ROIC (%)	6.5%	5.2%	5.7%	6.3%	6.0%	5.9%	5.9%	6.1%
Net debt / EBITDA (x)	0.7	4.1	3.4	2.6	2.7	2.9	2.7	2.2
Gearing (%)	19.2%	86.3%	90.0%	66.5%	82.2%	109.2%	100.8%	82.1%
Valuation								
P/E adjusted	20.8	18.4	13.0	13.4	25.1	20.9	20.6	20.5
P/E adjusted and fully diluted	20.8	18.4	13.0	13.4	25.1	20.9	20.6	20.5
P/BV	0.9	1.1	0.9	1.0	1.6	1.8	1.8	1.8
P/CF	4.5	10.7	3.7	4.6	7.4	6.3	6.1	6.1
Dividend yield (%)	4.7%	8.5%	4.7%	9.1%	4.2%	4.6%	4.6%	4.6%
FCF yield (%)	14.9%	-5.1%	3.5%	18.3%	11.3%	9.5%	10.1%	8.3%
EV/Sales	0.9	3.4	2.9	2.9	3.7	3.6	3.5	3.3
EV/EBITDA	3.7	9.1	6.6	6.3	7.8	7.4	7.2	6.8
EV/EBIT	7.3	17.7	14.9	13.5	17.5	16.5	15.7	15.2

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Prices in this report are taken as of the previous day's close (to the date of this report) on the home market unless otherwise stated.

Companies mentioned

Stock	ISIN	Currency	Price
ERG	IT0001157020	EUR	16.27

Source: Factset closing prices of 15/05/2019

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Name of the Research Analyst(s): Claudia Introvigne

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Rating Breakdown	A	B
Buy	49%	50%
Hold	34%	33%
Reduce	14%	12%
Not Rated/Under Review/Accept Offer	3%	5%
Total	100%	100%

Source: KEPLER CHEUVREUX

A: % of all research recommendations

B: % of issuers to which material services of investment firms are supplied

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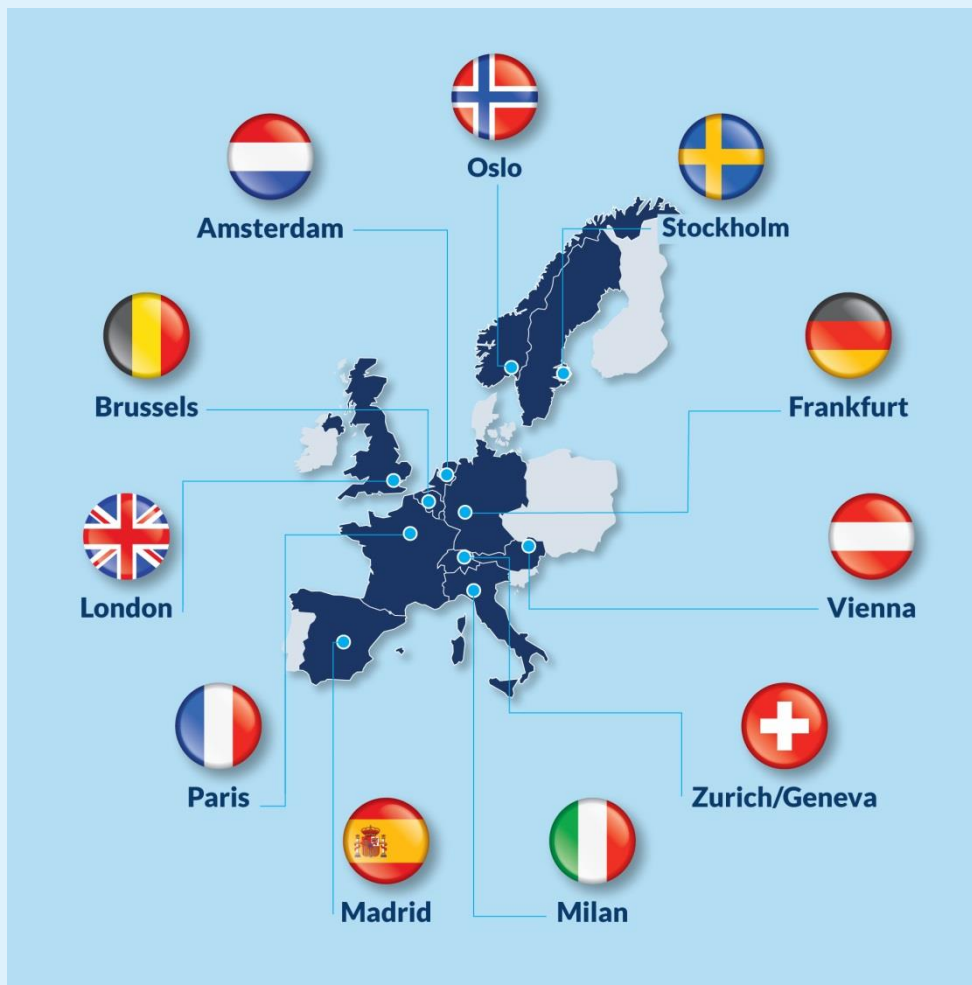
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