

# EDP

## Power purchase agreements and Privatisation

### Onward and upward

# SNAPSHOT

- The uncertainty with regards the compensations for the termination of the power purchase agreements between EDP's power stations and REN should be removed over the next few weeks.
- EDP's privatisation is likely to occur earlier than initially expected. We note that the Portuguese government is likely to sell a 16% stake, comparing with a 20% stake as in the last public offering.
- News flow on EDP is likely to remain favourable and the stock remains attractive on a relative basis. We therefore maintain our Buy (Medium Risk) rating on EDP with a YE04 price target of €2.60.

Yesterday, the Portuguese Economy Minister hosted a press conference with regards the termination of the termination of the power purchase agreements, the privatisations timetable and the restructuring of Galp Energia.

The new information that came out to the market with regards the termination of the power purchase agreements was:

- As expected, the net present value of the compensation to be received by EDP for the termination of its power purchase agreements (the so-called CMECs) will be calculated as the difference between the NPV of the power purchase agreements and a market-based scenario as initially expected;
- The CMECs of each power producer will be spread out across the years remaining until the end of its power purchase agreement with a highest lifetime. In case of EDP, we believe that the CMECs will be spread out across 23 years (EDP's power purchase agreement with a higher lifetime is that of Venda Nova Hydro plant that ends up in 2027). This mechanism is a means of decreasing electricity tariffs;
- As expected, the CMECs will be paid by all customers (i.e included in the global use of system tariff) and will be paid to each of the power producers as a monthly stream;
- Over the next ten years, there will be a plant-by-plant adjustment mechanism to the initial level of CMECs to take into consideration the differences between the actual achieved levels of output, pool prices and fuel costs and the original estimates. In 2014, there will be a final adjustment with regards the remaining years until the end of the PPAs;
- A draft of the final PPAs compensation-law is currently open to discussion. Over the past two days, the Portuguese government has also already presented this methodology to the European Union. According to the Portuguese Economy Minister, the EU's review process is expected to be fast and the EU is expected to approve this methodology. We note that Mr. Carlos Tavares has already met the EU as a means of speeding up the process. We recall that EDP stated that the termination of its PPAs is subject to tangible evidence that the EU will not block the payment of stranded costs as they did in Spain in spite of the fact that the formal approval of the EU should not be required (due to the private status of the PPAs and the fact that they are considered to be binding and closed contracts in legal terms);

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## Outstanding Power Purchase Agreements

Producer	Plant	Type	Installed Capacity (MW)	Start	End
EDP	Barreiro	Fuel Oil	56	1978	2009
EDP	Carregado	Fuel Oil / Gas	710	1968	2010
EDP	Setúbla	Fuel Oil	946	1979	2012
EDP	Sines	Coal	1,192	1985	2017
EDP	Tapada do Outeiro	Fuel Oil	47	1959	2004
EDP	Tunes	Fuel Oil	197	1973	2007
EDP	Agueira	Hydro	336	1981	2024
EDP	Alto Lindoso	Hydro	630	1992	2024
EDP	Alto Rabagao	Hydro	68	1964	2015
EDP	Bemposta	Hydro	240	1964	2013
EDP	Bouça	Hydro	44	1955	2015
EDP	Cabril	Hydro	108	1954	2015
EDP	Caldeirão	Hydro	40	1994	2024
EDP	Canicada	Hydro	62	1954	2015
EDP	Carrapatelo	Hydro	201	1971	2024
EDP	Castelo Bode	Hydro	159	1951	2015
EDP	Crestuma	Hydro	117	1985	2024
EDP	Fratel	Hydro	132	1974	2020
EDP	Miranda	Hydro	369	1960	2013
EDP	Paradela	Hydro	54	1956	2015
EDP	Picote	Hydro	195	1958	2013
EDP	Pocinho	Hydro	186	1983	2024
EDP	Pracana	Hydro	41	1950	2024
EDP	Raiva	Hydro	24	1982	2024
EDP	Regua	Hydro	180	1973	2024
EDP	Salamonde	Hydro	42	1953	2015
EDP	Tabuaço	Hydro	58	1965	2024
EDP	Torao	Hydro	140	1988	2024
EDP	Touvedo	Hydro	22	1993	2024
EDP	Valeira	Hydro	240	1976	2024
EDP	Venda Nova	Hydro	90	1951	2027
EDP	Vilarinho Furnas	Hydro	125	1972	2022
Tejo Energia	Pego	Coal	615	1993	2021
Turbogas	Tapada do Outeiro	Gas	990	1997	2024

Source: Economy Ministry

Regarding the privatisations timetable, we highlight three points:

- Contrary to what was initially expected, the sale of some of the remaining government holding in EDP will occur before the initial public offering of Galp Energia (which is to be left with a core group of upstream and downstream oil assets) and of REN (which is to be left with the electricity and gas transmission activities). According to the Economy Minister, these privatisations should be concluded in a timeframe of 360 days, as previously announced;
- The government will privatise a stake of up to 16% of EDP, i.e., it will keep a direct stake in EDP of at least 10%. The Portuguese government remains EDP's largest shareholder with a 26.1% stake held directly. EDP's remaining major shareholders are: BCP (5.1%), Iberdrola (5.0%), CGD (4.9%) and Brisa (2.0%);
- The voting rights for any shareholder excluding the Portuguese State will remain limited to 5% by the Privatisation Decree Law;

## EDP's Shareholder Structure

	# Shares	Economic Stake	% of Voting Rights
Direcção Geral do Tesouro	568,853,506	18.96%	19.10%
Parública	214,220,570	7.14%	7.19%
Caixa Geral de Depósitos	145,316,948	4.84%	4.88%
BCP	151,635,713	5.05%	5.00%
Iberdrola	149,966,455	5.00%	5.00%
Brisa	60,002,297	2.00%	2.01%
Treasury shares	21,430,964	0.71%	-
Free float	1,688,573,547	56.29%	56.69%
Total	3,000,000,000	100.00%	
# Issued shares	3,000,000,000		
# Treasury shares	21,430,964		
# Outstanding shares	2,978,569,036		

Source: Company data

Regarding the restructuring of Galp Energia, we highlight two points:

- Apparently, the €3.2bn equity value for Galp Energia set out in the agreements between its major shareholders was after 2003 dividends (reportedly ENI will receive €1.1bn for its 33.34% stake of Galp Energia, on top of the dividends associated with 2003). This should not imply any change to our earlier thoughts on the exchange ratios implied in the announced agreements between the major shareholders of Galp Energia as all of the shareholders should receive those dividends;
- The Portuguese government entered into an agreement with Iberdrola in which the former will approve the sale of the stakes in Beiragás and Tagusgás to the latter;

Other interesting items included:

- The government is to sell a 33.34% to 45% stake of Galp Energia to a strategic partner over the next few months through a private placement;
- The private equity funds Carlyle and CVC (owner of Lecta), as well as Viacer, were reported to be interested in Galp Energia. Viacer comprises some of Unicer's shareholders, including Violas Group (46%), Arsopi (28%) and BPI (26%). Mr. Manuel Ferreira de Oliveira, the current CEO of Unicer, was Galp Energia's CEO in the past;
- After the sale of 33.34% to 45% of Galp Energia to a strategic partner, the government is to sell some of its remaining holding through a public offering until the end of 1Q05.

## Comment

Considering the new information that came out to the market, we highlight two points:

- The uncertainty with regards the compensations to be paid for the termination of the power purchase agreements should be removed over the next few weeks with the conclusion of the consultation period as well as with the EU's approval;
- EDP's privatisation may occur slightly earlier than previously expected. We note that the Portuguese government is likely to sell a 16% stake, comparing with a 20% stake as in the last public offering (In October 2000, the Portuguese government placed a 20% stake at €3.1 per share);

The announced adjustment mechanism will leave EDP exposed to market risks after the next 10

years depending on the assumptions to be used in the calculation of the final adjustment by 2014.

#### EDP's Outstanding PPAs Breakdown per Maturity

MW	2004	2007	2009	2010	2012	2013	2015	2017	2020	2022	2024	2027
Installed Capacity	47	197	56	710	946	804	537	1192	132	125	2215	90
Type	Thermal	Thermal	Thermal	Thermal	Thermal	Hydro	Hydro	Thermal	Hydro	Hydro	Hydro	Hydro
%	1%	3%	1%	10%	13%	11%	8%	17%	2%	2%	31%	1%

*Source: Finance Ministry*

However, this risk is reduced by the fact that the PPAs of EDP's thermal plants will mature before 2014, with the exception of the Sines coal plant, which matures in 2017. We emphasise that the PPAs of hydro plants do not imply an exposure to fuel prices risk. We also note that a recovery in the form of a fixed stream of payments after 2014 should make a securitisation of the CMECs easier.

News flow is likely to remain favourable for EDP and the stock looks attractive on a relative basis (EDP is currently trading at an EV/EBITDA 04 multiple of 7.8x against the Iberian competitive energy sector on 8.3x).

We therefore reiterate our Buy (Medium risk) rating on EDP with a YE04 price target of €2.60.