

EDP**BUY**

Preparing Renewables IPO

RECOMMENDATION UPGRADED TO BUY FROM HOLD

CURRENT PRICE: €4.10

TARGET PRICE: €5.15

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(34) 91 289 4413

- **We are upgrading EDP to Buy from Hold** in the wake of EDP's announcement that it is starting preparations for the IPO of its renewable energy arm (Neo+Horizon – N+H). **Buy EDP** on the back of:

- (1) **26% upside potential** implicit in target price.
- (2) **Higher correlation between EDP's and Iberdrola Renovables' (IBR) share prices**, following IPO announcement. Based on IBR's market cap (€21.2bn) and assuming N+H's portfolio is 40% of IBR's, we arrive at a valuation for N+H of €8.5bn (€9.4bn in our SOTP). **This implies upside potential of 19%**. Also, given EDP's relative performance vs IBR since the latter's IPO in December, **we see room for EDP to outperform IBR by 10%**.
- (3) **Exposure to green energy**. Over 50% of EDP's EV comes from clean energy: 28% from renewables and at least 25% from hydro capacity. The IPO could boost the visibility of this part of the business.
- (4) **Low risk**. Some 60% of EDP's conventional generation portfolio is protected from rising CO₂ emission costs and declining margins in Iberian generation, via CMECs. We see this as a clear positive in the coming years, due to expected oversupply in Iberia and rising input costs.

Relative Performance (12 Months)



Source: JCF.

Company Data, January, 28, 2008

| | EDP.LS / EDP PL | (€mn) | 2005 | 2006 | 2007E | 2008E | 2009E |
|------------------------|---------------------|---------------|---------|---------|---------|---------|---------|
| Reuters/Bloomberg code | EDP.LS / EDP PL | | | | | | |
| Market cap (€ mn) | 14,991.8 | EBITDA | 2,047.5 | 2,305.4 | 2,790.9 | 3,203.2 | 3,578.5 |
| Outst shares (mn) | 3,656.5 | % change | – | 12.6 | 21.1 | 14.8 | 11.7 |
| Website | www.edp.pt | Net income | 1,071.1 | 940.7 | 1,002.8 | 972.6 | 1,099.9 |
| Free float (%) | 43.0 | % change | – | -12.2 | 6.6 | -3.0 | 13.1 |
| Avg daily vol (€ mn) | 80.8 | EPS (€) | 0.20 | 0.22 | 0.23 | 0.27 | 0.30 |
| 12-month range (€) | 3.73-4.91 | EV/EBITDA (x) | 13.8 | 12.2 | 10.1 | 8.8 | 7.9 |
| Performance (%) | -1M -3M -12M | P/E (x) | 20.4 | 19.0 | 17.6 | 15.4 | 13.6 |
| Absolute | -7.9% -5.7% 6.5% | GDY (%) | 2.4 | 2.7 | 3.0 | 3.4 | 3.8 |
| Relative to PSI-20 | 8.3% 9.6% 10.9% | FCF yield (%) | 5.3 | 3.6 | 11.4 | -8.3 | 2.3 |

Source: Reuters, Bloomberg.

Source: Company data and Banco Santander de Negócios Portugal estimates.

SOTP VALUATION

Figure 1. EDP – SOTP Valuation, YE2008E

| (€mn) | Stake (%) | EV of | | % of EDP's EV | Implicit 2008E EV/EBITDA (x) | Methodology |
|---|--------------|----------|-----------------|------------------|---------------------------------|---|
| | | 100% | EDP's Stake | | | |
| Iberia | | | | | | |
| Generation and supply ¹ | 100.0 | 13,982.3 | 13,982.3 | 41.7 | 9.8 | DCF |
| Distribution | 100.0 | 5,312.9 | 5,312.9 | 15.9 | 8.1 | DCF |
| Gas | 100.0 | 1,629.9 | 1,629.9 | 4.9 | 8.9 | DCF |
| Renewable energy ² | 100.0 | 9,376.2 | 9,376.2 | 28.0 | 20.8 | SOTP, DCF |
| Energias do Brasil | 62.4 | 4,189.2 | 2,614.0 | 7.8 | 5.2 | Target price US\$21.32/share ⁴ |
| Financial investments | — | — | 953.6 | 2.8 | — | — |
| Edinfor | 40.0 | — | 46.0 | — | — | Book value |
| REN | 30.0 | — | 106.8 | — | — | BSNP target price: €4.00/share |
| CERJ | 8.0 | — | 39.2 | — | — | 50% BV net of unrealised losses |
| BCP | 2.4 | — | 353.8 | — | — | BSNP target price €3.00/share |
| Sonaecom | 8.0 | — | 112.2 | — | — | BSNP target price €3.85/share |
| Turbogás | 40.0 | — | 158.4 | — | — | €500 EV/kWh, assuming 25% D/E |
| Tejo Energia | 11.1 | — | 20.0 | — | — | Book value |
| Others | — | — | 117.2 | — | — | Book value |
| Holding costs | — | — | -357.8 | -1.1 | 5.0 | 2008E EV/EBITDA of 5x |
| Enterprise value | — | — | 33,511.3 | 100.0 | — | — |
| YE2007E net financial debt ³ | — | — | -12,102.5 | — | — | — |
| Adjustment to net debt | — | — | -759.0 | — | — | — |
| Adjusted minorities ⁵ | — | — | -813.6 | — | — | — |
| Uncovered pension fund and medical liabilities | — | — | -1,224.9 | — | — | — |
| Equity value | — | — | 18,646.3 | — | — | — |
| Number of shares (mn) | — | — | 3,656.5 | — | — | — |
| Own shares (mn) | — | — | -12.7 | — | — | — |
| Value per share (€) | — | — | 5.12 | — | — | — |
| Rounding | — | — | 0.03 | — | — | — |
| Target price (€/share) | — | — | 5.15 | — | — | — |

(1) Ex renewables. (2) Including 40% stake in equity accounted project of 1,200MW wind capacity to be developed in Portugal. (3) Adjusted for €449mn of dividends to be paid in 1H08E. (4) Per Santander Investment Securities. (5) Equity value of minorities adjusted for 37.6% of Energias do Brasil's EV, already deducted above.
Source: Company data and Banco Santander de Negócios Portugal estimates.



Important Disclosures

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Grupo Santander has received compensation for investment banking services from EDP in the past 12 months.

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KEY TO INVESTMENT CODES*

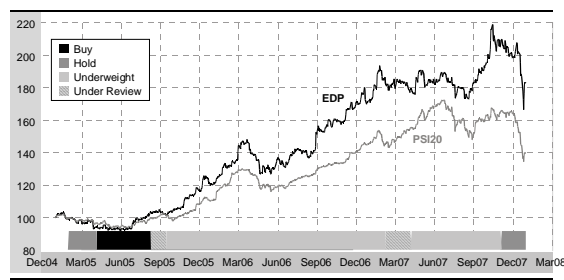
| Rating | Definition | % of Companies as of Jan 2008 | |
|---------------------|--------------------------|-------------------------------|---|
| | | Covered with This Rating | Provided with Investment Banking Services in Past 12M |
| Buy | Upside of more than 15%. | 42.39 | 45.28 |
| Hold | Upside of 10%-15%. | 10.87 | 7.55 |
| Underweight | Upside of less than 10%. | 33.70 | 30.19 |
| Under Review | | 13.04 | 16.98 |

(*) Target prices set from January to June are for December 31 of the current year. Target prices set from July to December are for December 31 of the following year.

LOCAL OFFICES

| | | | |
|--|---|--|---|
| Madrid Tel: 34-91-257-2309 Fax: 34-91-257-1811 | Lisbon Tel: 351-21-389-3400 Fax: 351-21-387-9133 | London Tel: 44-207-332-6900 Fax: 44-207-332-6909 | New York Tel: 212-692-2550 Fax: 212-407-4540 |
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3Y STOCK PERFORMANCE VS RATING



Source: JCF and Banco Santander de Negócios Portugal.

EDP

CURRENT PRICE: €4.10
TARGET PRICE: €5.15
Buy

EDP evolved from Portugal's incumbent electricity distributor and the leading generator in Portugal (44% of EV) to a major player in the Iberian scenario in the last seven years, grabbing a 20% share in electricity generation (Spain accounts for c12% of EV). On top of this, EDP operates in Brazil's electricity generation and distribution markets, through its 62% stake in Energias do Brasil (8% of EV) and has recently expanded its wind-energy operations to the US, France and Poland, becoming the fourth-largest wind player worldwide (28% of EV). In Iberia, 60% of EDP's conventional generation portfolio is protected from low prices and rising costs through CMECs – the value-neutral equilibrium mechanism established to compensate EDP for the early termination of PPAs.

Financial Data: P&L, Balance Sheet and CF Statement, 2004-09E

| P&L Account (€mn) | 2004 | 2005 | 2006 | 2007E | 2008E | 2009E | CAGR 06-09E (%) |
|------------------------|--------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Total revenues | 0.0 | 8,584.4 | 8,984.5 | 9,698.0 | 10,356.5 | 11,040.2 | 7.1 |
| YoY change (%) | - | - | 4.7 | 7.9 | 6.8 | 6.6 | - |
| COGS | 0.0 | -5,813.2 | -6,191.4 | -6,421.4 | -6,669.3 | -7,030.1 | - |
| Gross profit | 0.0 | 14,397.6 | 15,175.9 | 16,119.4 | 17,025.8 | 18,070.3 | - |
| As % of revenues | - | 167.7 | 168.9 | 166.2 | 164.4 | 163.7 | - |
| Personnel expenses | 0.0 | -546.0 | -585.1 | -630.2 | -665.2 | -676.7 | - |
| Other op expenses | 0.0 | 11,804.1 | 12,285.4 | 12,698.3 | 13,157.4 | 13,815.1 | - |
| EBITDA | 0.0 | 2,047.5 | 2,305.4 | 2,790.9 | 3,203.2 | 3,578.5 | 22.8 |
| YoY change (%) | - | - | 12.6 | 21.1 | 14.8 | 11.7 | - |
| As % of revenues | - | 23.9 | 25.7 | 28.8 | 30.9 | 32.4 | - |
| EBIT | 0.0 | 1,136.1 | 1,253.0 | 1,772.9 | 2,077.8 | 2,323.0 | 22.8 |
| YoY change (%) | - | - | 10.3 | 41.5 | 17.2 | 11.8 | - |
| As % of revenues | - | 13.2 | 13.9 | 18.3 | 20.1 | 21.0 | - |
| Net interest expenses | 0.0 | -364.0 | 37.9 | -387.8 | -505.0 | -542.8 | - |
| Extraordinary items | 0.0 | 492.0 | 4.8 | 152.5 | 0.0 | 0.0 | - |
| Pre-tax profits | 0.0 | 1,264.1 | 1,295.7 | 1,537.6 | 1,572.8 | 1,780.2 | 11.2 |
| YoY change (%) | - | - | 2.5 | 18.7 | 2.3 | 13.2 | - |
| Taxes | 0.0 | -152.2 | -278.7 | -410.2 | -465.8 | -527.2 | - |
| Tax rate (%) | - | 12.0 | 21.5 | 26.7 | 29.6 | 29.6 | - |
| Minority interests | 0.0 | -40.9 | -76.3 | -124.6 | -134.4 | -153.1 | - |
| Net profit | 0.0 | 1,071.1 | 940.7 | 1,002.8 | 972.6 | 1,099.9 | 5.3 |
| YoY change (%) | - | - | -12.2 | 6.6 | -3.0 | 13.1 | - |
| Adj. Net profit | 733.1 | 787.9 | 850.4 | 972.6 | 1,099.9 | 1,224.0 | - |
| Balance Sheet (€mn) | 2004 | 2005 | 2006 | 2007E | 2008E | 2009E | CAGR 06-09E (%) |
| Fixed assets | 0.0 | 18,318.0 | 19,758.0 | 23,919.1 | 26,087.4 | 27,627.5 | - |
| Goodwill | - | - | - | - | - | - | - |
| Inventories | 0.0 | 219.2 | 229.0 | 247.2 | 264.0 | 281.4 | - |
| Trade receivables | 0.0 | 1,585.5 | 1,593.4 | 1,719.9 | 1,836.7 | 1,958.0 | - |
| Cash & equivalents | 0.0 | 861.1 | 869.0 | 869.0 | 869.0 | 869.0 | - |
| Total assets | 0.0 | 24,033.0 | 25,407.1 | 30,080.9 | 32,512.8 | 34,371.1 | - |
| Shareholders' equity | 0.0 | 4,823.4 | 5,527.3 | 5,835.0 | 6,358.7 | 6,955.8 | - |
| LT financial debt | 0.0 | 8,600.7 | 8,625.0 | 10,994.5 | 13,262.3 | 14,023.9 | - |
| ST financial debt | 0.0 | 1,983.6 | 1,528.0 | 1,528.0 | 1,528.0 | 1,528.0 | - |
| Trade payables | 0.0 | 4,685.3 | 5,865.8 | 7,712.8 | 7,214.4 | 7,556.3 | - |
| CF Statement (€mn) | 2004 | 2005 | 2006 | 2007E | 2008E | 2009E | CAGR 06-09E (%) |
| Op cash flow | 0.0 | 2,219.9 | 2,007.9 | 2,576.9 | 2,804.2 | 3,118.1 | - |
| Chg in working capital | 0.0 | 0.0 | -17.9 | 1,334.3 | -762.0 | 23.7 | - |
| Capex | 0.0 | -1,429.2 | -1,456.5 | -2,198.7 | -3,293.7 | -2,795.6 | - |
| Dividends | 0.0 | 0.0 | -363.9 | -401.4 | -448.9 | -502.8 | - |
| Free cash flow | 0.0 | 790.7 | 533.6 | 1,712.5 | -1,251.6 | 346.2 | - |

Source: Company data and Banco Santander de Negócios Portugal estimates.

Per Share Data, 2006-09E

| (€) | 2006 | 2007E | 2008E | 2009E |
|------------|-------|-------|--------|--------|
| EPS | 0.22 | 0.23 | 0.27 | 0.30 |
| % chg | 7.5 | 7.9 | 14.4 | 13.1 |
| Adj EPS | 0.22 | 0.23 | 0.27 | 0.30 |
| % chg | 7.5 | 7.9 | 14.4 | 13.1 |
| DPS | 0.11 | 0.12 | 0.14 | 0.15 |
| % chg | 10.0 | 12.0 | 12.0 | 12.0 |
| CFPS | 0.55 | 0.70 | 0.77 | 0.85 |
| % chg | -9.5 | 28.3 | 8.8 | 11.2 |
| FCFPS | 0.15 | 0.47 | -0.34 | 0.09 |
| % chg | -32.5 | 221.0 | -173.1 | -127.7 |
| Div payout | 51.0 | 53.0 | 51.9 | 51.4 |
| % chg | 2.3 | 3.8 | -2.1 | -1.0 |

Source: Company data and BSNP estimates.

Market Ratios, 2006-09E

| (x) | 2006 | 2007E | 2008E | 2009E |
|-----------|------|-------|-------|-------|
| P/E | 19.0 | 17.6 | 15.4 | 13.6 |
| EV/sales | 3.1 | 2.9 | 2.7 | 2.6 |
| EV/EBITDA | 12.2 | 10.1 | 8.8 | 7.9 |
| EV/EBIT | 22.5 | 15.9 | 13.6 | 12.1 |
| P/CF | 7.5 | 5.8 | 5.3 | 4.8 |
| P/BV | 2.7 | 2.6 | 2.4 | 2.2 |
| FCF yield | 3.6 | 11.4 | -8.3 | 2.3 |
| GDY | 2.7 | 3.0 | 3.4 | 3.8 |

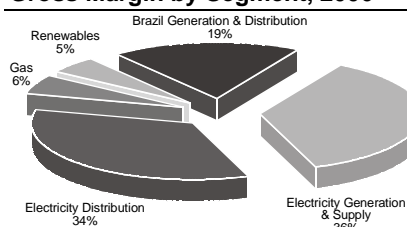
Source: Company data and BSNP estimates.

Financial Ratios, 2006-09E

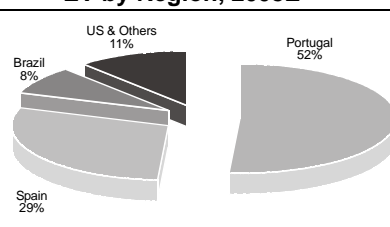
| (%) | 2006 | 2007E | 2008E | 2009E |
|--------------|------|-------|-------|-------|
| ROE | 18.2 | 17.7 | 16.0 | 16.5 |
| ROCE | 5.3 | 7.3 | 7.7 | 7.7 |
| D/E | 1.9 | 1.8 | 1.6 | 1.5 |
| D/EBITDA (x) | 5.4 | 4.4 | 3.9 | 3.5 |
| Int cover | 60.8 | -7.2 | -6.3 | -6.6 |

Source: Company data and BSNP estimates.

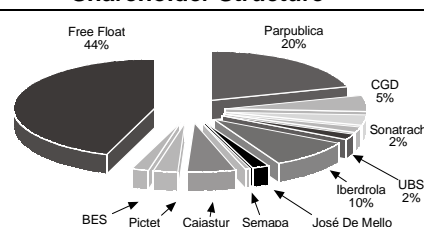
Gross Margin by Segment, 2006



EV by Region, 2008E



Shareholder Structure



Source: Company data and Banco Santander de Negócios Portugal estimates.