

Equity | Italy | Oils  
19 July 2010

# Potential GALP exit; killing two birds with one stone?

## Options for GALP exit?

Increasing press speculation has surrounded Eni's 33% stake in GALP (Buy; EUR12.37; PO EUR17/sh). With GALP shareholders' standstill agreement expiring at end-10 and limited scope to gain control of the company, it is not difficult to see Eni looking for an exit route. Whilst GALP's assets are highly attractive, we believe its political importance limits the number of potential suitors (Sonangol; Amorim; PBR; CDG) and, thus, Eni's options. The key for Eni is to balance its need to expand its upstream asset base while keeping debt in check and giving investors comfort on the dividend sustainability. And we believe that this is exactly what a GALP deal could provide as we see a combination of cash and upstream asset swap for Eni's stake as the likely outcome of any transaction. We value Eni's GALP stake at EUR4.65bn.

## 2Q earnings: weak downstream to offset decent upstream

Eni's 2Q results (due 28 Jul) are key to prove the progress made on its upstream portfolio. In a quarter that maintenance/GoM disruption is set to feature heavily in the peer group, Eni's upstream production (1.75mboe/d, +0.9% YoY) appears relatively decent. That said, we see this being partially offset by its below par downstream assets – still showing small losses despite the recovery in margins – and an Italian nat gas business still under competitive pressure – we see gas sales down 3% YoY. All-in, we forecast group EBIT at EUR3.85m (-11% QoQ) and an interim dividend of EUR0.5/sh (flat YoY).

## Retaining Neutral rating

We are making small (<1%) tweaks to our EPS as we head into 2Q. Eni's YTD underperformance has started to open a small valuation gap: Eni trades on 7.1x 2011E P/E against Euro Integrated on 7.4x. That said, it is fairly small and not enough to move the needle yet. We maintain our Neutral rating.

## Estimates (Dec)

(EUR)	2008A	2009A	2010E	2011E	2012E
EPS (Adjusted Diluted)	2.59	1.44	1.84	2.21	2.21
EPS Change (YoY)	0.3%	-44.4%	28.0%	20.0%	0%
Dividend / Share	1.30	1.00	1.00	1.03	1.05
ADR EPS (Adjusted Diluted - US\$)	7.57	3.99	4.77	5.72	5.72
ADR Dividend / Share (US\$)	3.80	2.78	2.59	2.66	2.72

## Valuation (Dec)

	2008A	2009A	2010E	2011E	2012E
P/E	5.9x	10.6x	8.3x	6.9x	6.9x
Dividend Yield	8.5%	6.5%	6.5%	6.7%	6.9%
EV / EBITDA*	2.7x	3.7x	3.1x	2.7x	2.7x
Free Cash Flow Yield*	14.1%	-3.1%	6.9%	7.8%	9.1%

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 7.

## Bank of America Merrill Lynch

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## Stock Data

Price (Common / ADR)	EUR15.28 / US\$40.72
Price Objective	EUR19.40 / US\$52.66
Date Established	13-Nov-2009 / 13-Nov-2009
Investment Opinion	A-2-8 / A-2-8
Volatility Risk	LOW / LOW
52-Week Range	EUR14.30-EUR18.77
Market Value (mn)	EUR55,350
Shares Outstanding (mn)	3,622.4 / 1,811.2
Average Daily Volume	17,415,680
BofAML Ticker / Exchange	EIPAF / MIL
BofAML Ticker / Exchange	E / NYS
Bloomberg / Reuters	ENI IM / ENI.MI
ROE (2010E)	13.7%
Net Dbt to Eqty (Dec-2009A)	46.1%
Est. 5-Yr EPS / DPS Growth	3.0% / -5.2%
Free Float	69.7%

## Key Changes

(EUR)	Previous	Current
2010E EPS	1.85	1.84

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Refer to important disclosures on page 8 to 11. Analyst Certification on Page 6. Price Objective Basis/Risk on page 5. Link to Definitions on page 5. 10955486

# *iQprofile*<sup>SM</sup> Eni

Key Income Statement Data (Dec)	2008A	2009A	2010E	2011E	2012E
<b>(EUR Millions)</b>					
Sales	108,190	85,757	73,255	80,034	79,997
EBITDA Adjusted	30,728	22,301	26,644	30,494	30,680
Depreciation & Amortization	(8,935)	(9,179)	(9,932)	(10,533)	(11,274)
EBIT Adjusted	21,793	13,122	16,712	19,961	19,406
Net Interest & Other Income	745	149	(113)	(47.4)	48.0
Tax Expense / Benefit	(10,625)	(7,123)	(9,071)	(10,835)	(10,404)
Net Income (Adjusted)	9,416	5,207	6,667	8,003	8,000
Average Fully Diluted Shares Outstanding	3,639	3,622	3,622	3,622	3,622

## Key Cash Flow Statement Data

Net Income (Reported)	8,028	4,367	7,067	8,003	8,000
Depreciation & Amortization	8,935	9,179	9,932	10,533	11,274
Change in Working Capital	(278)	(1,901)	(370)	0	0
Deferred Taxation Charge	0	0	0	0	0
Other CFO	4,904	(379)	922	658	634
<b>Cash Flow from Operations</b>	<b>21,589</b>	<b>11,266</b>	<b>17,552</b>	<b>19,195</b>	<b>19,908</b>
Capital Expenditure	(13,752)	(12,998)	(13,726)	(14,857)	(14,892)
(Acquisition) / Disposal of Investments	(4,637)	(2,727)	9.00	0	0
Other CFI	1,195	3,612	997	0	0
<b>Cash Flow from Investing</b>	<b>(17,194)</b>	<b>(12,113)</b>	<b>(12,720)</b>	<b>(14,857)</b>	<b>(14,892)</b>
Share Issue / (Repurchase)	(409)	0	0	0	0
Cost of Dividends Paid	(5,010)	(2,956)	(3,622)	(3,668)	(3,759)
Increase (decrease) debt	0	3,935	494	(671)	(1,256)
Other CFF	0	(3,935)	(494)	671	1,256
<b>Cash Flow from Financing</b>	<b>(5,419)</b>	<b>(2,956)</b>	<b>(3,622)</b>	<b>(3,668)</b>	<b>(3,759)</b>
<b>Total Cash Flow (CFO + CFI + CFF)</b>	<b>(1,024)</b>	<b>(3,803)</b>	<b>1,210</b>	<b>671</b>	<b>1,256</b>
FX and other changes to cash	(1,025)	3,059	(284)	(671)	(1,256)
Change in Cash	(2,049)	(744)	926	0	0
Change in Net Debt	2,049	4,679	(432)	(671)	(1,256)
Net Debt	18,376	23,055	22,623	21,953	20,696

## Key Balance Sheet Data

Property, Plant & Equipment	59,255	59,765	75,436	81,777	87,556
Goodwill	2,084	2,084	2,084	2,084	2,084
Other Intangibles	5,629	9,385	9,362	9,362	9,362
Other Non-Current Assets	7,193	7,538	7,320	7,320	7,320
Trade Receivables	18,802	20,348	23,660	23,660	23,660
Cash & Equivalents	2,489	1,745	2,671	2,671	2,671
Other Current Assets	6,102	5,495	5,517	5,517	5,517
<b>Total Assets</b>	<b>101,554</b>	<b>106,360</b>	<b>126,050</b>	<b>132,391</b>	<b>138,170</b>
Long-Term Debt	20,865	24,800	25,294	24,624	23,367
Other Non-Current Liabilities	596	7,757	19,367	22,043	24,839
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	31,526	23,752	26,089	26,089	26,089
<b>Total Liabilities</b>	<b>52,987</b>	<b>56,309</b>	<b>70,750</b>	<b>72,756</b>	<b>74,295</b>
<b>Total Equity</b>	<b>48,567</b>	<b>50,051</b>	<b>55,300</b>	<b>59,635</b>	<b>63,876</b>
<b>Total Equity &amp; Liabilities</b>	<b>101,554</b>	<b>106,360</b>	<b>126,050</b>	<b>132,391</b>	<b>138,170</b>

## Business Performance\*

Return On Capital Employed	16.3%	8.62%	9.17%	9.69%	8.90%
Return On Equity	22.2%	11.5%	13.7%	15.0%	13.8%
Operating Margin	17.2%	14.3%	23.4%	24.9%	24.3%
Free Cash Flow (MM)	7,837	(1,732)	3,826	4,339	5,016

## Quality of Earnings\*

Cash Realization Ratio	2.29x	2.16x	2.63x	2.40x	2.49x
Asset Replacement Ratio	1.54x	1.42x	1.38x	1.41x	1.32x
Tax Rate	54.8%	57.3%	53.4%	54.4%	53.5%
Net Debt/Equity	37.8%	46.1%	40.9%	36.8%	32.4%
Interest Cover	31.7x	19.0x	19.4x	22.7x	25.2x

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 7.

## Company Description

Eni is an integrated oil and gas company with a focus on international upstream and European natural gas, downstream, power generation and chemicals businesses.

## Investment Thesis

Eni's perceived defensive characteristics have been offset by a weak position in downstream and limited growth on the E&P side of the business. Historically Eni has addressed the shortcomings around E&P reserves through a series of bolt-on acquisitions and we may see the company turning to the M&A arena again to replenish its portfolio.

## Stock Data

Shares / ADR	2.00
Price to Book Value	1.1x

## Key Changes (ADR)

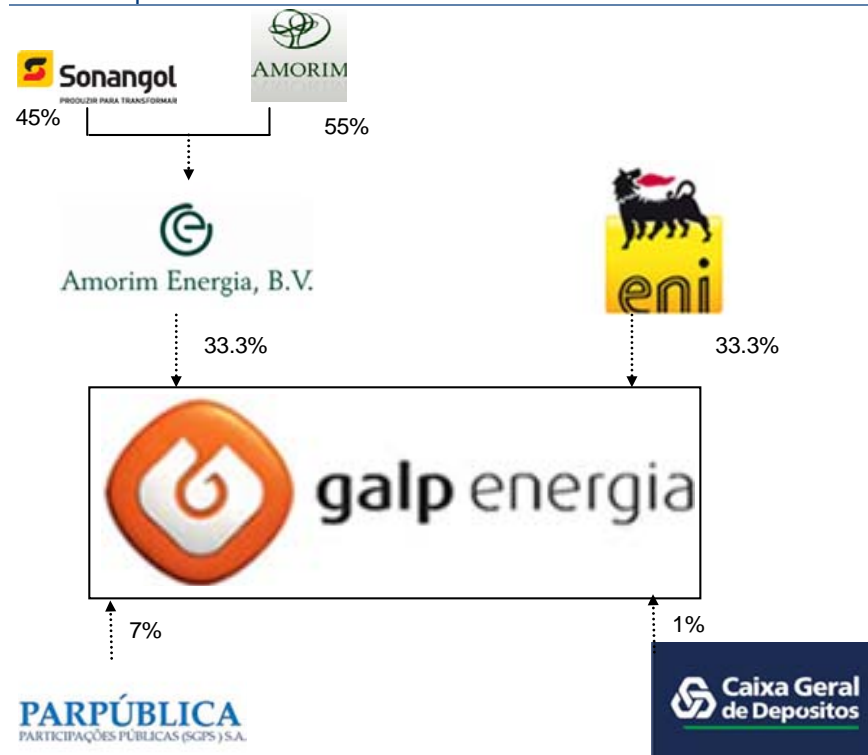
(US\$)	Previous	Current
2010E EPS	4.78	4.77
2011E EPS	5.73	5.72
2012E EPS	5.73	5.72

## Options for GALP exit?

Increasing press speculation has surrounded in recent weeks Eni's 33% stake in GALP (Buy; PO EUR17/sh). With GALP shareholders' standstill agreement expiring at end-10 and limited scope to gain control of the company, it is not difficult to see Eni looking for an exit route.

Whilst GALP's assets are highly attractive (Brazil Santos Basin, Angola), we believe its political importance limits the number of potential suitors to existing shareholders (Sonangol; Amorim; CDG) or new players with strong political connections (eg, PBR). Thus, the situation limits Eni's options for any potential deal.

### Exhibit 1: Galp: main shareholders



Source: BofA Merrill Lynch Global Research based on company data

The key for Eni is to balance its need to expand its upstream asset base while keeping debt in check (or even reducing it) and giving investors comfort on the dividend sustainability. And we believe that this is exactly what a GALP deal could provide as we see a combination of cash and upstream asset swap for Eni's stake as the likely outcome of any transaction. We value Eni's GALP stake at EUR4.65bn.

## 2Q earnings: weak downstream to offset decent upstream

Eni's 2Q results (due 28 Jul) are key to prove the progress made on its upstream portfolio. In a quarter that maintenance/GoM disruption is set to feature heavily in the peer group, Eni's upstream production (1.75mboe/d, +0.9% YoY) appears relatively decent. That said, we see this being partially offset by its below par

downstream assets – still showing small losses despite the recovery in margins – and an Italian nat gas business still under competitive pressure – we see gas sales down 3% YoY. All-in, we forecast group EBIT at EUR3.85m (-11% QoQ) and an interim dividend of EUR0.5/sh (flat YoY).

Table 1: Eni 2Q10E results preview (in EUR million)

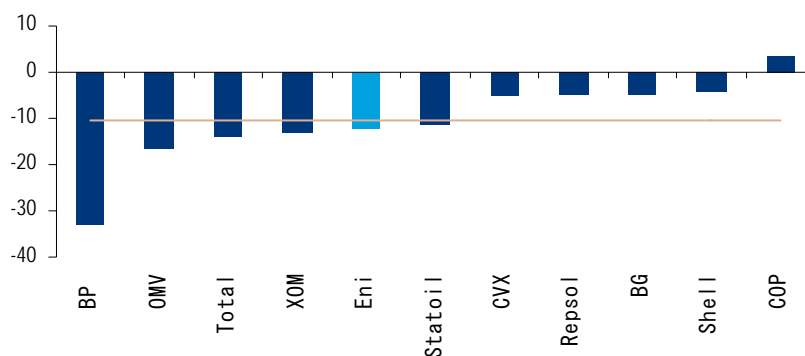
	BofAML 2Q10E	2Q09	1Q10	YoY	QoQ
<b>Income statement:</b>					
E&P	3,087	2,064	3,118	50%	-1%
Gas & Power	744	690	1,267	8%	-41%
R&M	(71)	(106)	(94)	-33%	-24%
Chemicals	(19)	(146)	(59)		
Other	108	321	690		
<b>Operating profit</b>	<b>3,849</b>	<b>2,549</b>	<b>4,331</b>	<b>51%</b>	<b>-11%</b>
Net financial income	(15)	114	108		
Tax rate (%)	56%	25%	53%		
<b>Adjusted net income</b>	<b>1,476</b>	<b>902</b>	<b>1,822</b>	<b>64%</b>	<b>-19%</b>
Adjusted EPS (EUR)	0.41	0.25	0.50	64%	-19%
<b>Memo items:</b>					
Realised oil price (US\$/bbl)	71.9	54.4	70.9	32%	1%
Realised gas price (US\$/mcf)	5.90	5.03	5.73	17%	3%
EUR/USD - average	1.28	1.36	1.35	-6%	-5%
<b>E&amp;P volumes (kboepd)</b>	<b>1,749</b>	<b>1,733</b>	<b>1,816</b>	<b>0.9%</b>	<b>-3.7%</b>
Gas sales (BCM)	19.9	20.5	30.5	-2.9%	-35%

Source: BofA Merrill Lynch Global Research

## Retaining Neutral rating

We are making small (<1%) tweaks to our EPS as we head into 2Q. Eni's YTD underperformance has started to open a small valuation gap.

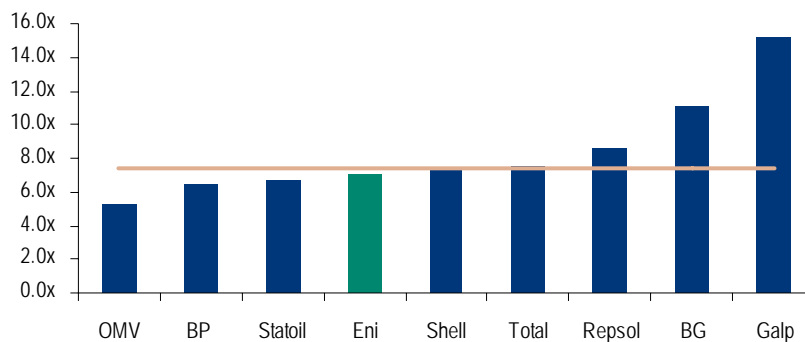
Chart 1: Integrated Oils YTD performance (% in local currencies)



Source: datastream

Eni trades on 7.1x 2011E P/E against Euro Integrates on 7.4x. That said, it is fairly small and not enough to move the needle yet. We maintain our Neutral rating.

Chart 2: European Integrateds 2011E P/E



Source: BofA Merrill Lynch Global Research

## Price objective basis & risk

### Eni (EIPAF / E)

Our price objective of EUR 19.4/share puts Eni in line with sector average earnings (P/E) multiples for 2011, which for us is also a year where we expect mid-cycle earnings. Our rationale is that we see little to differentiate the shares relative to sector peers from an operational or momentum standpoint over the next 12 months.

The risks to attaining our price objective relate to (1) moves in the oil price (2) moves in the Euro/dollar exchange rate (3) political interference in the countries in which the company operates (4) production levels below expectations (5) delays/cost overruns in new projects and (6) m&a risk as the company tries to rebuild its portfolio inorganically.

### Galp Energia (GLPEF)

Our price objective of EUR17 per share is based on our sum-of-parts valuation, incorporating the Refining & Marketing business at 5x 2012e EV/EBITDA (less upgrading capex), Gas & Power at 7x EV/EBITDA and the Exploration & Production business, using a 10% discount rate, at an average of US\$2.8/boe. Note that in the E&P segment we include an assessment of the risked potential of the ongoing exploration programme in Brazil.

Risks are oil prices and refining margins, Portuguese electricity and natural gas prices and changes to Government regulation and fiscal terms.

## Link to Definitions

### Energy

Click [here](#) for definitions of commonly used terms.

## Analyst Certification

I, Alejandro Demichelis, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

### EMEA - Integrated & Refiners Coverage Cluster

Investment rating	Company	BofAML ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	BG	BRGYY	BRGYY US	Hootan Yazhari, CFA
	BG Group	BRGXF	BG/ LN	Hootan Yazhari, CFA
	Galp Energia	GLPEF	GALP PL	Hootan Yazhari, CFA
	Motor Oil-Hellas	MOHCF	MOH GA	James Schofield
	OMV	OMVJF	OMV AV	Hootan Yazhari, CFA
	OMV	OMVKY	OMVKY US	Hootan Yazhari, CFA
	Petroplus	PEPFF	PPHN VX	James Schofield
	Repsol-YPF	REP	REP US	Hootan Yazhari, CFA
	Repsol-YPF	REPYF	REP SM	Hootan Yazhari, CFA
	Royal Dutch Shell	RDSB	RDS/B US	Alejandro Demichelis
	Royal Dutch Shell	RYDBF	RDSB LN	Alejandro Demichelis
	Royal Dutch Shell PLC Shs A	RDSA	RDS/A US	Alejandro Demichelis
	Royal Dutch Shell PLC Shs A	RYDAF	RDSA LN	Alejandro Demichelis
	Statoil	STO	STO US	Hootan Yazhari, CFA
	Statoil	STOHF	STL NO	Hootan Yazhari, CFA
<b>NEUTRAL</b>				
	BP plc	BP	BP US	Alejandro Demichelis
	BP plc	BPAQF	BP/ LN	Alejandro Demichelis
	Eni	E	E US	Alejandro Demichelis
	Eni	EIPAF	ENI IM	Alejandro Demichelis
	Neste Oil	NTOIF	NES1V FH	James Schofield
	Saras SPA	SAAFF	SRS IM	James Schofield
	Total	TTFNF	FP FP	Alejandro Demichelis
	Total	TOT	TOT US	Alejandro Demichelis
<b>UNDERPERFORM</b>				
	ERG SpA	ERGZF	ERG IM	James Schofield
	Hellenic Petro	HLCPF	ELPE GA	James Schofield
	ORL	XORFF	ORL IT	James Schofield

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**iQmethod<sup>SM</sup> Measures Definitions**

<b>Business Performance</b>	<b>Numerator</b>	<b>Denominator</b>
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
<b>Quality of Earnings</b>		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	$\text{Net Debt} = \text{Total Debt, Less Cash \& Equivalents}$	Total Equity
Interest Cover	EBIT	Interest Expense
<b>Valuation Toolkit</b>		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

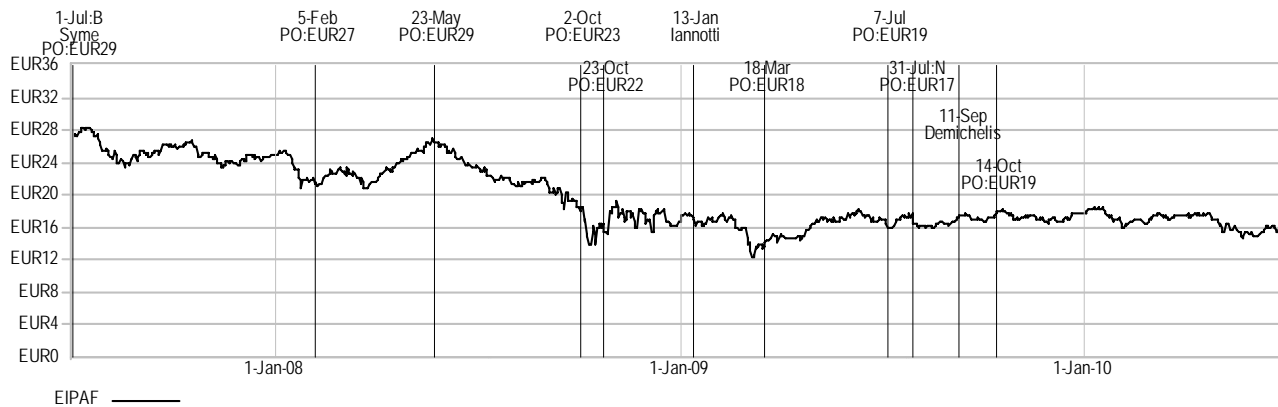
*iQmethod<sup>SM</sup>* is the set of BofA Merrill Lynch standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of *iQmethod* are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

*iQdatabase<sup>®</sup>* is our real-time global research database that is sourced directly from our equity analysts' earnings models and includes forecasted as well as historical data for income statements, balance sheets, and cash flow statements for companies covered by BofA Merrill Lynch.

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## Important Disclosures

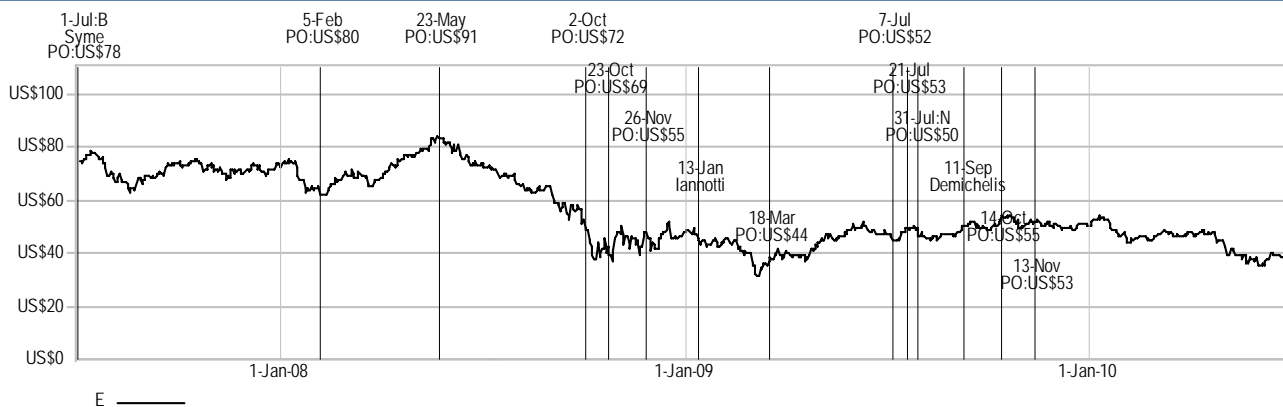
### EIPAF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

"Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of June 30, 2010 or such later date as indicated. BofAML price charts do not reflect analysts' coverage of the stock at prior firms. Historical price charts relating to companies covered as of December 31, 2008 by former Banc of America Securities LLC (BAS) analysts are available to BAS clients on the BAS website."

### E Price Chart



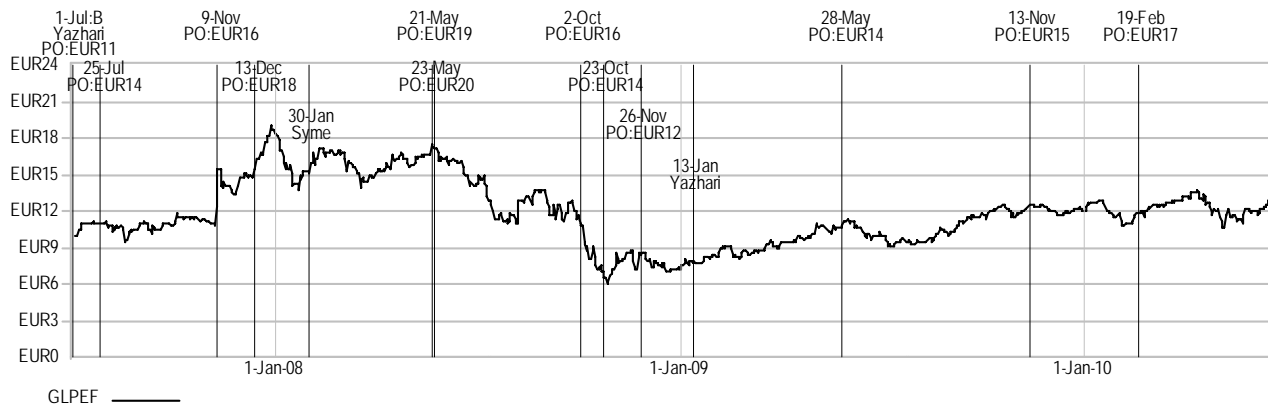
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## GLPEF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

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## Investment Rating Distribution: Energy Group (as of 01 Jul 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	177	64.60%	Buy	116	72.96%
Neutral	48	17.52%	Neutral	18	47.37%
Sell	49	17.88%	Sell	26	57.78%

## Investment Rating Distribution: Global Group (as of 01 Jul 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1922	54.14%	Buy	1042	59.85%
Neutral	874	24.62%	Neutral	496	62.78%
Sell	754	21.24%	Sell	362	51.86%

\* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
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