Back to reasonable territory

Event

- We were sellers during the recent share price spike, which was triggered by increased visibility of MVV’s shareholder structure. Since February 22, the stock has lost 16% and fallen below our reiterated target price of €24. Consequently, we upgrade our rating to Neutral.

Impact

- Resilience of earnings: A key attraction of MVV is the resilience of operating profits and EPS, despite the current economic crisis and the absence of free CO2 allocations as of 2013. This resilience comes from cost cutting and MVV’s diversified mix of regulated and non-regulated activities in the electricity, gas, district heating and environmental businesses. We also argue that the political environment for MVV remains supportive, especially for its combined head and power (CHP) and district heating businesses.

- Investment-driven growth opportunities: The MVV 2020 strategy includes €1.5bn growth capex for the current decade. Important milestones will be the new waste-to-energy plant in Plymouth (CDO 2014, €250m capex, €20m estimated EBIT in average) and the new 911MW CHP plant GKM9, COD in 2015. Hence, we expect a notable EBIT increase from ~€230m-250m over the next three years to €280m in 2014/15.

- Share overhang is a key short-term risk: GSZ (2.9% direct stake +3.4% derivatives) and EnBW (15.1+7.4%) recently unmasked higher-than-expected positions in MVV. This triggered takeover speculation, but we have consistently argued that both might rather reduce than increase their positions. We regard share overhang as a key risk for the share price.

- Valuation is high, but a PER premium is justified: The recent share price decline has reduced MVV’s 2013E PER to ~15x. This is a considerable premium to the EU utilities sector’s multiple of ~9x (based on our estimates). We flag that the company’s defensive and diversified business model justifies a valuation premium. Our DCF value of €24 suggests a fair value 2013 PER of 16x, and a theoretical PER based on DDM works out to 17x, after assuming the earnings growth from current growth investments.

Earnings and target price revision

- There is no change to our earnings estimates and valuation.

Price catalyst

- 12-month price target: €24.00 based on a DCF methodology.

- Catalyst: Commodity prices and generation spreads, changes in shareholder structure, operating performance.

Action and recommendation

- We regard the company as attractive, given the resilience of earnings and long-term capex-driven growth. In our view, the recent share price decline has taken the valuation back to a reasonable territory, thus we upgrade to Neutral.

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Important disclosures:

**Recommendation definitions**

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<tr>
<th>Macquarie - Australia/New Zealand</th>
<th>Outperform</th>
<th>return &gt;3% in excess of benchmark return Neutral – return within 10% of benchmark return Underperform – return &lt;3% below benchmark return</th>
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<td>Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield</td>
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**Volatility index definition**

This is calculated from the volatility of historical price movements.

**High** – stock should be expected to move up or down at least 25–30% in a year.

**Medium** – stock should be expected to move up or down at most 30–40% in a year.

**Low** – stock should be expected to move up or down at most 15–25% in a year.

**Recommendations** – 12 months

**Note:** Quant recommendations may differ from Fundamental Analyst recommendations

**Financial definitions**

*All "Adjusted" data items have had the following adjustments made:

**Add back:** goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense

Excluded: non recurring items, asset revalu, property revals, appraisal value uplift, preference dividends & minority interests

**EPS** – adjusted net profit / epsgov

**ROA** – adjusted ebit / average total assets

**ROA Banks/Insurance** – adjusted net profit /average total assets

**ROE** – adjusted net profit / average shareholders funds

**Gross cashflow** – adjusted net profit + depreciation

Equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

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