**GERMANY**

**MVV1 GR Underperform**

Close Price* 21 Feb 12  
€27.04

- **12-month target**  
€24.00
- **12-month TSR**  
-7.9

**Valuation**  
€24.33

- DCF (WACC 10.5%, beta 1.1, ERP 5.0%, RFR 4.0%, TGR 2.0%)

**GICS sector**  
Utilities

**Market cap**  
€m 1,782

**30-day avg turnover**  
€m 0.1

**Market cap US$m**  
2,364

**Number shares on issue**  
m 65.91

**Investment fundamentals**

<table>
<thead>
<tr>
<th>Year end 30 Sep</th>
<th>2011A</th>
<th>2012E</th>
<th>2013E</th>
<th>2014E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>m</td>
<td>3,590.5</td>
<td>3,660.6</td>
<td>3,827.8</td>
</tr>
<tr>
<td>Reported profit</td>
<td>m</td>
<td>117.2</td>
<td>98.3</td>
<td>98.7</td>
</tr>
<tr>
<td>EPS rep</td>
<td>€</td>
<td>1.78</td>
<td>1.49</td>
<td>1.50</td>
</tr>
<tr>
<td>EPS rep growth</td>
<td>%</td>
<td>-15.7</td>
<td>-16.1</td>
<td>0.4</td>
</tr>
<tr>
<td>PER rep</td>
<td>x</td>
<td>15.2</td>
<td>18.1</td>
<td>18.1</td>
</tr>
<tr>
<td>Total DPS</td>
<td>€</td>
<td>0.90</td>
<td>0.90</td>
<td>0.90</td>
</tr>
<tr>
<td>Total DPS growth</td>
<td>%</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Total div yield</td>
<td>%</td>
<td>3.3</td>
<td>3.3</td>
<td>3.3</td>
</tr>
<tr>
<td>Net debt/equity</td>
<td>%</td>
<td>80.6</td>
<td>88.2</td>
<td>95.9</td>
</tr>
<tr>
<td>P/BV</td>
<td>x</td>
<td>1.6</td>
<td>1.5</td>
<td>1.5</td>
</tr>
</tbody>
</table>

**MVV1 GR vs Stoxx600, & rec history**

Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, February 2012

(all figures in EUR unless noted)

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**MVV Energie**

Risks skewed to the downside

**Event**

- MVV’s share price has responded positively to the announcement of GDF Suez as a new shareholder. This contradicts our view that GDF’s shareholding may be a share overhang. Moreover, the operating performance in 1Q was weak, which we think rules out any positive earnings surprise for the full year. Consequently, we downgrade our rating from Neutral to Underperform.

**Impact**

- **Share overhang in place**: GSZ has recently unmasked a 6.3% stake in MVV, which was hidden behind a financial derivatives contract. We believe GSZ has acted as a pure financial investor and can hardly realize a strategic value in this shareholding. As such, we believe GSZ could become a seller of the stock.
- **Weak 1Q makes full-year targets challenging**: MVV’s 1Q adjusted EBIT was down 19%, due to extraordinarily mild weather conditions and a power plant outage. We believe management’s guidance (“single-digit EBIT decline”) is attainable, but challenging.
- **Valuation is high, but a PER premium is justified**: MVV is trading at a 2013E PER of 18x, at a considerable premium to the EU utilities sector’s multiple of 10x (based on our estimates). We flag that the company’s defensive and diversified business model justifies a valuation premium. However, our DCF value of €24 suggests a fair PER of 16x, and a theoretical PER based on DDM works out to 17x even after assuming earnings growth until 2015, when current growth investments become operational.

**Earnings and target price revision**

- No change.

**Price catalyst**

- 12-month price target: €24.00 based on a DCF methodology.
- Catalyst: Commodity prices & generation spreads, changes in shareholder structure, operating performance

**Action and recommendation**

- We have frequently highlighted MVV’s earnings resilience even in the current difficult macroeconomic environment, medium-term investment driven earnings growth and a generally supportive political environment for the company. All these factors support our DCF-based target price of €24 and, in our view, explain the significant valuation premium to the EU utilities sector.
- The recent positive share price reaction following the revelation of GSZ’s small stake in MVV, however, represents a downside risk for the share price, in our view. Moreover, the tough 1Q has made management’s full-year targets challenging, so we believe earnings risks for the full year are skewed to the downside.
- The stock currently trades 13% above our unchanged target price of €24. Consequently, we downgrade our rating from Neutral to Underperform.

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22 February 2012  
Macquarie Capital (Europe) Limited

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Weak 1Q – Meeting full-year earnings guidance has become challenging

Fig 1 1Q11/12 results overview

<table>
<thead>
<tr>
<th>EUR m</th>
<th>1Q2011/12</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Actual</td>
<td>Macq (e)</td>
</tr>
<tr>
<td>Adjusted EBITDA</td>
<td>114.0</td>
<td>113.1</td>
</tr>
<tr>
<td>Generation, Infrastructure</td>
<td>37.0</td>
<td>36.0</td>
</tr>
<tr>
<td>Trading, portfolio management</td>
<td>3.6</td>
<td>4.3</td>
</tr>
<tr>
<td>Sales &amp; services</td>
<td>14.1</td>
<td>15.0</td>
</tr>
<tr>
<td>Strategic investments</td>
<td>16.3</td>
<td>16.8</td>
</tr>
<tr>
<td>Others</td>
<td>3.4</td>
<td>3.0</td>
</tr>
<tr>
<td>Adjusted EBIT</td>
<td>74.3</td>
<td>75.1</td>
</tr>
<tr>
<td>Interest result</td>
<td>-14.4</td>
<td>-13.5</td>
</tr>
<tr>
<td>Taxes</td>
<td>-7.9</td>
<td>-8.5</td>
</tr>
<tr>
<td>Minorities</td>
<td>-3.3</td>
<td>-2.0</td>
</tr>
<tr>
<td>Net profit</td>
<td>11.3</td>
<td>16.1</td>
</tr>
<tr>
<td>EPS</td>
<td>0.17</td>
<td>0.24</td>
</tr>
<tr>
<td>Adjusted net profit</td>
<td>37.3</td>
<td>39.9</td>
</tr>
<tr>
<td>Adjusted EPS</td>
<td>0.57</td>
<td>0.61</td>
</tr>
</tbody>
</table>

Source: Company data, Macquarie Research, February 2012

MVV faced a tough 1Q2011/12 (October–December 2011). The two main effects were:

- **Mild weather conditions:** Due to warm weather conditions, heating degree days declined by 17% compared with 1Q10/11. Hence, adjusted EBIT in Sales & Services declined by almost 30%. Strategic investments, which bundle several participations in local utilities also weighed on the quarter’s performance, with EBIT dropping 18% YoY. MVV did not quantify the earnings impact of the weather conditions, but the earnings decline in both divisions (€9m) provides a good indication in this respect.

- **€10m one-off costs due to the GKK plant outage:** The GKK power plant outage in Kiel triggered (operating) one-off cost of “slightly above €10m”, which was marginally more than we had anticipated. As a result, adjusted EBIT of the Trading & Portfolio management division, which includes the earnings impact of generation prices and volumes, fell to €4m.

**All in all, adjusted EBIT was down 19% to €74m**, which was slightly below our expectations. The main factor was the abovementioned power plant outage, which accounts for almost 60% of this decline (55%).

Fig 2 Meeting full-year guidance has become challenging

<table>
<thead>
<tr>
<th>EUR m</th>
<th>FY 2010/11A</th>
<th>FY 2011/12E</th>
<th>+/-</th>
<th>Guidance (15 Feb 2012)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>3,615</td>
<td>3,691</td>
<td>2.1%</td>
<td>slight increase</td>
</tr>
<tr>
<td>adjusted EBIT</td>
<td>242</td>
<td>226</td>
<td>-6.7%</td>
<td>slight (single-digit) decline</td>
</tr>
</tbody>
</table>

Source: Company data, Macquarie Research, February 2012

Management has reiterated its expectation of a "single-digit €-adjusted EBIT decline" for FY2011/12. The weak 1Q (-19% or -€17m) has made this a challenge. However, we flag that the main drags on earnings were specific to 1Q.

Even assuming normalized operating conditions and a flat EBIT for Q2-4, MVV would still come in at the low end of its full-year target (a 9.9% EBIT decline means -€24m EBIT). However, 2Q has been comparably cold so far, and tariff increases should have slightly positive earnings impact as well. We therefore stick to our full-year EBIT estimate of €226m (-7%), but see little upside risk if any.

Revealing of GDF Suez’s stake indicates share overhang

On February 08, 2012, GDF Suez (GSZ FP, €19.82, Outperform, TP: €28.00, Atallah Estephan) revealed the ownership of a 6.3% stake in MVV Energie, following the expiry of a financial derivatives contract. GDF Suez hasn’t commented further on its intention – whether it plans to keep this stake, offload it, or buy more shares.

As we have outlined before, we assume that GSZ bought the direct and indirect stakes in 2007, and the expiry of the derivatives contract merely unmasked this. To us, this means that GSZ has acted as a pure financial investor so far.
Mannheim to keep majority control over MVV: In response to GDF Suez’s announcement, the mayor of Mannheim and head of MVV’s supervisory board, Dr. Kurz, reiterated that the majority stake in MVV is “part of the city’s identity”. As such, we think there’s little chance of any of the free-float investors gaining control over MVV – or sell its stake at a strategic premium on top of the current share price.

Revealing of GDF Suez’s stake indicates a share overhang: We believe GDF Suez’s announcement indicates a share overhang for the following reasons:

- The small shareholding with a market value of ~€100m has little rationale for GSZ going forward.
- If GSZ wanted to increase its stake, it could easily get in touch with the other MVV shareholders, especially EnBW (15%) and Rheinenergie (16%) – without unmasking its own shareholding.
- If GSZ was considering selling its 6% stake, it made sense to show its stake to the investment community and potentially sell if it found the price attractive.

Fair value remains at €24 – a premium to the sector PER is justified

MVV’s current share price implies a PER 2012/13E of 18x, compared with the current EU utilities sector PER of 10x. We flag that:

- MVV’s fair PER would also be 10x, assuming a theoretical growth rate of 3% in dividends (this translates from 8.5% RoE times 40% payout ratio).
- If we apply our estimated EPS 2011–15 CAGR of 5.8%, we end up with a fair PER of 17x. Our 2015E EPS already includes the earnings impact from the €250m growth investment in Plymouth.
- Our DCF-based fair value implies a fair PER of 16x.

Fig 4  Fair PER derived from dividend discount model

<table>
<thead>
<tr>
<th></th>
<th>2012/13</th>
<th>2012/13</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(at theoretical growth rate)</td>
<td>(at estimated 2011–15 CAGR)</td>
</tr>
<tr>
<td>P (current share price)</td>
<td>27.1</td>
<td>27.1</td>
</tr>
<tr>
<td>D (Dividend)</td>
<td>0.90</td>
<td>0.90</td>
</tr>
<tr>
<td>E (Earnings)</td>
<td>1.50</td>
<td>1.50</td>
</tr>
<tr>
<td>RoE (return on equity %)</td>
<td>8.3%</td>
<td>8.3%</td>
</tr>
<tr>
<td>k (required return %)</td>
<td>9.4%</td>
<td>9.4%</td>
</tr>
<tr>
<td>g (growth rate in dividends %)</td>
<td>3.3%</td>
<td>5.8%</td>
</tr>
<tr>
<td>The dividend discount model’s results</td>
<td></td>
<td></td>
</tr>
<tr>
<td>P = D/(k - g)</td>
<td>15</td>
<td>26</td>
</tr>
<tr>
<td>k = (D/P) + g</td>
<td>6.6%</td>
<td>9.2%</td>
</tr>
<tr>
<td>P/E = (D/E)/(k - g)</td>
<td>9.9</td>
<td>17.2</td>
</tr>
</tbody>
</table>

Source: Macquarie Research, February 2012
Important disclosures:

**Recommendation definitions**

**Macquarie - Australia/New Zealand**
- **Outperform** – return >3% in excess of benchmark return
- **Neutral** – return within 3% of benchmark return
- **Underperform** – return <3% below benchmark return

**Macquarie – Asia/Europe**
- **Outperform** – expected return >10%
- **Neutral** – expected return from -10% to +10%
- **Underperform** – expected return <10%

**Macquarie First South - South Africa**
- **Outperform** – expected return >10%
- **Neutral** – expected return from -10% to +10%
- **Underperform** – expected return <10%

**Recommendation proportions – For quarter ending 31 December 2011**

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>AU/NZ</th>
<th>RSA</th>
<th>USA</th>
<th>CA</th>
<th>EUR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outperform</td>
<td>56.59%</td>
<td>65.60%</td>
<td>54.55%</td>
<td>44.53%</td>
<td>75.28%</td>
</tr>
<tr>
<td>Neutral</td>
<td>33.45%</td>
<td>20.55%</td>
<td>38.96%</td>
<td>50.20%</td>
<td>22.47%</td>
</tr>
<tr>
<td>Underperform</td>
<td>9.96%</td>
<td>13.85%</td>
<td>6.49%</td>
<td>5.27%</td>
<td>2.25%</td>
</tr>
</tbody>
</table>

**Volatility index definition**

This is calculated from the volatility of historical price movements.

**Very high–highest risk** – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

**High** – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock may be speculative.

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

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

**Low** – stock should be expected to move up or down at least 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:

- Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
- Excluded: non recurring items, asset valuations, appraisal value uplift, preference dividends & minority interests

**EPS** = adjusted net profit / eps

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

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

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

*equivalent fully paid ordinary weighted average number of shares

Financials data is as of: 30 September 2011

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

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