



06 October 2008

Utilities

Update

Price: € 1.92 Target price: € 3.0

Hera

Outperform from Neutral

Price: € 6.22 Target price: € 10.8

Enìa

Outperform

Two's company, three's a crowd

Exclusive 3-way talks have ended: is HERA – ENIA the last chance?

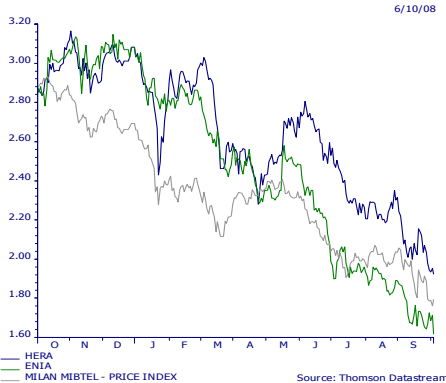
They've tried hard but apparently, a satisfactory solution was just too hard to be found. Call it love for one's chair, managerial pride or embarrassing political interference, at this point it doesn't really make a difference. We have plenty of sad evidence of how Italians still have a long way to go when it comes to this type of deals done. What's next? As far as we understand, a merger of neighbouring Hera and Enìa could be within easy reach; we would see this 2nd trial (the 1st came as a potential alternative to last year Enìa IPO), as a positive move; this despite recognizing that the potential absence of Irìde and its upstream assets does take away some of the deal industrial appeal. Moreover, step 1 (Hera – Enìa) doesn't necessarily exclude a facilitated step 2 (Hera- Enìa + Irìde). Finally, we highlight that some type of decision will have to be taken soon (over the next two weeks max) as next Spring political election in Bologna trigger the start of a six months "black out period" during which it will be impossible to take any decision.

Swap ratio, shareholders structure and corporate governance

Our Hera – Enìa merger simulation employs a 3.77x swap ratio obtained combining three different calculation methodologies: (1) Hera – Enìa volume weighted -1Y average prices (2) Hera – Enìa @ PT with Delmi NAV calculated using EDN -1Y average price (3) Hera – Enìa @ PT with Delmi NAV calculated using EDN average consensus PT. In all cases, mainly due to larger size, we assume Hera to be the consolidating entity.

Operating synergies @ 4% of combined 2009E EBITDA

We see value creation opportunities linked to improved gas procurement conditions, stronger downstream market positioning supported by cross selling and critical mass, more efficient network management, streamlined business model and capex optimization. On the basis of our preliminary calculation we come up with an NPV of foreseeable cost synergies of €390m, or €0.19 per Hera share and equal to some 14% of the post merger market capitalization. We move our rating on the Hera share from Neutral to Outperform PT@€3, and confirm Enìa's Outperform rating with PT@€10.8.



Hera Market Data

Market Cap (€ m)	1,955
Shares Out. (m)	1,017
Main Shareholder	Bologna Municip.14.99%
Free Float (%)	52.5
52 week range (€)	3.165-1.925
Rel Perf vs Mibtel (%)	
-1m	-1.0%
-3m	-10.2%
-12m	4.5%
21dd Avg. Vol. ('000)	3,347
Reuters/Bloomberg	HRA.MI / HER IM

Enìa Market Data

Market Cap (€ m)	668
Shares Out. (m)	108
Main Shareholder	RE PR PA Municip. 66.09%
Free Float (%)	0.4
52 week range (€)	12.05-6.195
Rel Perf vs Mibtel (%)	
-1m	-1.0%
-3m	-1.8%
-12m	-5.9%
21dd Avg. Vol. ('000)	149
Reuters/Bloomberg	EN.MI / EN IM

Combined entity

A move in the right direction Now that the long sought 3-way merger is inevitably fading away, the Hera – Enia option looks as an interesting second best; certainly the possible absence of Iride and its upstream assets does take away some of the industrial appeal, on the other hand, we are convinced that the deal still makes sense from an operational point of view and should be taken as a move in the right direction within the context of the highly fragmented and somewhat inefficient Italian local utilities market. A merger of the two companies would give birth to one of the largest local utilities in Italy with a combined market capitalization of around EUR2.7bn Revenues in excess of EUR5bn and EBITDA just short of EUR800m (2009E data - see table below).

Hera – Enià: Combined numbers

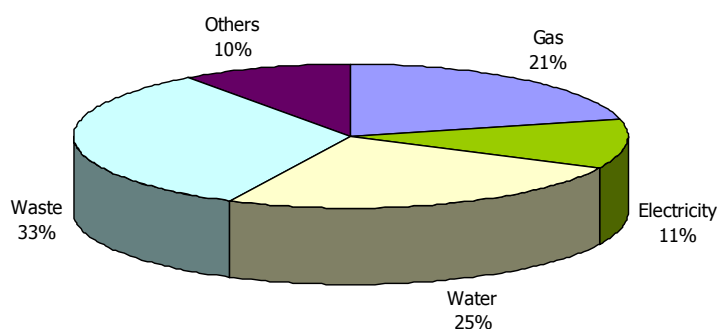
	2008E	2009E	2010E	2011E	2012E
Revenues	4,686	5,019	5,204	5,331	5,448
EBITDA post Synergies	701	782	848	887	948
Margin	15%	16%	16%	17%	17%
Assumed Synergies		8	16	26	32
EBITDA pre synergies	701	773	832	861	916
Margin	15%	15%	16%	16%	17%
Gas	155	163	172	178	183
Electricity	74	86	90	94	101
Water	173	194	212	225	237
Waste	231	254	276	280	310
Others	67	76	82	84	85
EBIT post synergies	381	442	495	522	570
EBIT pre synergies	381	434	479	496	537
Margin	8%	9%	9%	9%	10%
Net Profit post synergies	142	171	202	222	255
Net Profit pre synergies	142	166	191	204	232
Net Debt	2,109	2,194	2,176	2,088	1,917
Debt/EBITDA post synergies	3.01	2.81	2.57	2.35	2.02
Net invested Capital	4,385	4,512	4,542	4,492	4,365
NOSH	1,422,539				
MKT CAP	2,738				
EPS post synergies	0.10	0.12	0.14	0.16	0.18
EPS pre synergies	0.10	0.12	0.13	0.14	0.16
CFS pre synergies	0.32	0.36	0.38	0.40	0.43

Source: Mediobanca Securities

Newco still focussed on downstream activities Combining the two companies operating structures, we note that the post merger entity would still be strongly downstream oriented being short on gas and power and more focussed on customers. Within this context we are convinced that, also benefitting from territorial contiguity and from Hera proven track record in cost management post merger, the new entity would have at its disposal interesting value creation opportunities mainly linked to the achievement of higher efficiencies in managing networks and services offered to a larger and exploitable (cross selling) client base, as well as in the form of improved procurement conditions.

>60% of post merger EBITDA from regulated activities As illustrated in the following chart, the new companies key area of operation would be waste (33% of 2009E EBITDA), Water (25%) and Gas (21%); worthy of notice, on our forecast, over 60% of the post merger EBITDA would come from regulated activities.

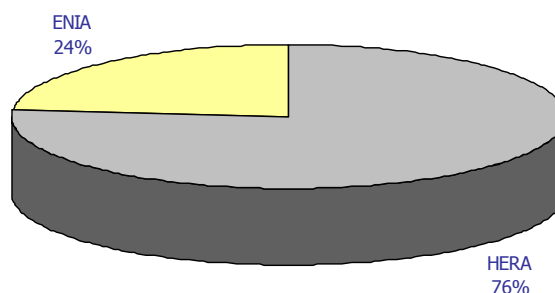
Hera – Enià: 2009E combined EBITDA breakdown



Source: Mediobanca Securities

Hera would turn out as the key contributor to the new company accounting, on our forecast, for close to 80% of the 2009E post merger EBITDA.

Hera – Enià: Contribution to 2009E combined EBITDA



Source: Mediobanca Securities

Post merger trading multiples broadly in line with sector averages

Hera – Enià: combined post synergies valuation multiples

	2008E	2009E	2010E	2011E	2012E
EV/SALES	1.03	0.98	0.94	0.91	0.85
EV/EBITDA	6.92	6.31	5.79	5.44	4.91
EV/EBIT	12.72	11.15	9.93	9.24	8.17
P/E	19.24	15.98	13.55	12.34	10.75
P/CF	5.93	5.36	4.93	4.67	4.33
Debt/EBITDA	3.01	2.81	2.57	2.35	2.02
D/E	0.77	0.80	0.79	0.76	0.70
D/EV	0.44	0.44	0.44	0.43	0.41

Source: Mediobanca Securities

Swap ratios

Our Hera – Enìa merger simulation employs a 3.77x swap ratio obtained combining three different calculation methodologies:

- (1) Hera – Enìa volume weighted -1Y average prices;
- (2) Hera – Enìa @ PT with Delmi NAV calculated using EDN -1Y average price
- (3) Hera – Enìa @ PT with Delmi NAV calculated using EDN average consensus PT.

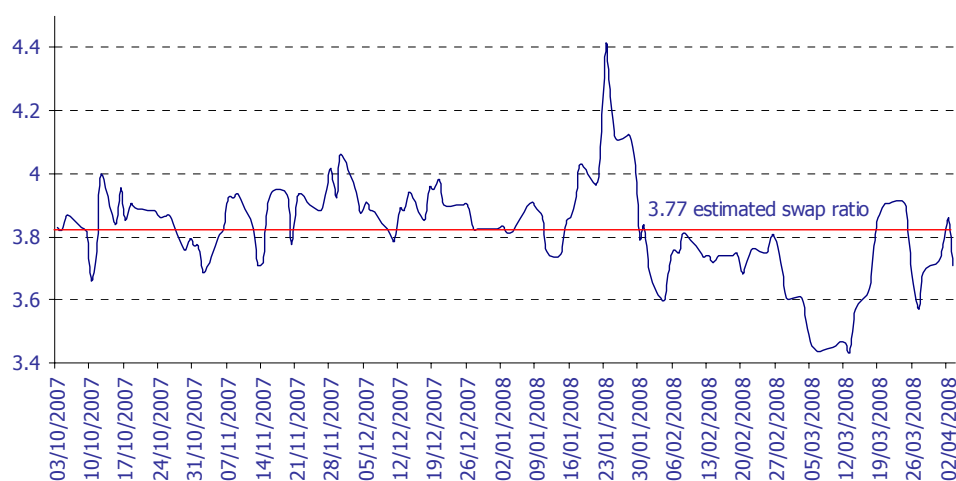
In all cases, mainly due to larger size, we assume Hera to be the consolidating entity. The following table summarizes our calculations.

Hera – Enìa: Swap ratio options

SWAP RATIOS	SPOT	YTD	-1M	-2M	-3M	-6M	-1Y
HERA avg P volume weighted	1.93	2.53	2.04	2.11	2.16	2.44	2.61
ENIA avg P volume weighted	6.20	9.12	6.57	6.78	6.99	8.24	9.95
HERA + ENIA	3.22	3.61	3.21	3.22	3.24	3.38	3.82
Implied Enìa price	6.20	6.95	6.19	6.19	6.23	6.50	7.35
Enìa current price	6.20						
Implied Upside	0%	12%	0%	0%	1%	5%	19%
Swap ratio on PT (NAV DELMI @ EDN -1Y avg MV)							3.61
Swap ratio on PT (NAV DELMI @ EDN consensus PT)							3.90
Average swap ratio							3.77

Source: Mediobanca Securities

Hera – Enìa: swap ratio evolution (12 months)

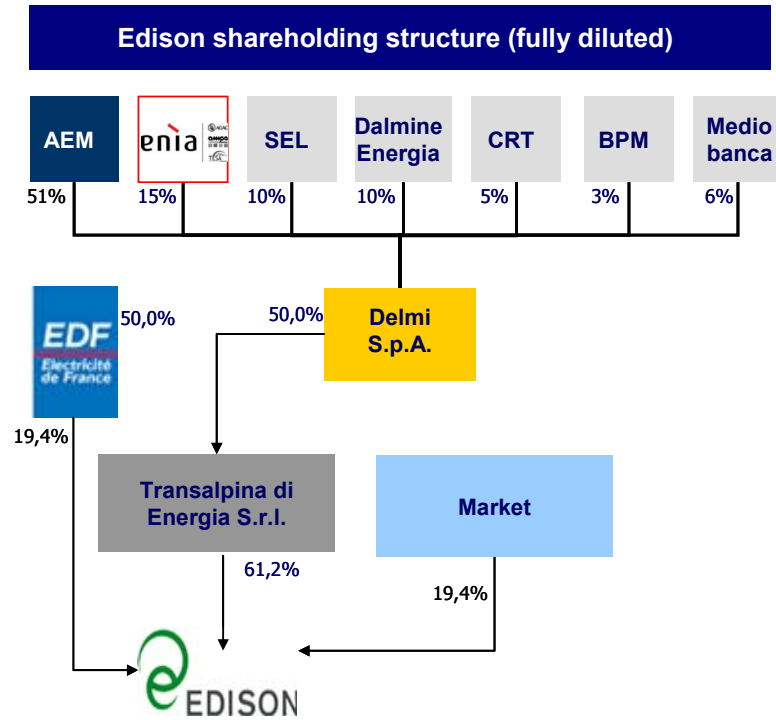


Source: Mediobanca Securities

Enia 15% stake in Delmi makes a difference...and offers alternative M&A options

As indicated in the table above the valuation of Enìa 15% stake in Delmi does represents a sensitive issue which will have to be addressed in defining the official swap ratio. Also, we would recall that, being a shareholder of Delmi somehow represents a direct link up with A2A which continues, in our view, to represent a valid M&A option for Enìa.

How long will it take before something changes?

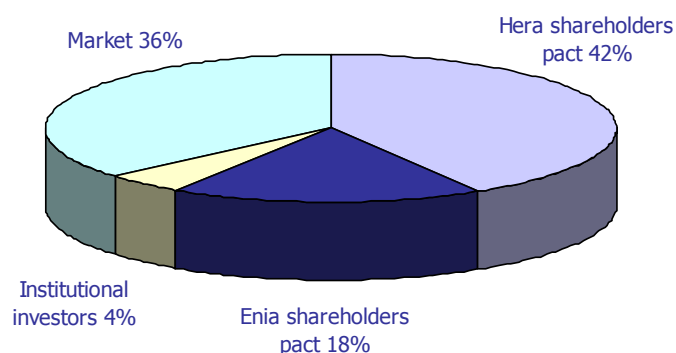


Source: Mediobanca Securities, companies

Shareholders structure and Corporate Governance

Using the already discussed 3.77x swap ratio and assuming Hera to be the consolidating entity, the post merger company would be provided with the shareholding structure shown below. We see this as a plausible solution as it would satisfy one of the key issues arisen during the unsuccessful 3-way merger talks, or the need to maintain public shareholders with a minimum 50% stake. As indicated in the picture below, according to our calculations, Hera + Enìa current municipal shareholders would be left with just about 50% of the new entity shareholding structure; at the same time, free float should turn out to a reasonable 36% which combined with larger size (combined market cap of about €2.7bn implying free float of around €1bn) should, in our opinion, make the stock more appealing to a larger number of investors.

Hera – Enìa Combined entity shareholding structure



Source: Mediobanca Securities

Quite clearly, we have no clue at this point over what type of post merger structure the two companies will decide to adopt; the only thing we feel like observing is that we hope they'll avoid hybrid forms of corporate governance such as the dual model (A2A offers plenty of evidence on this front); rather we would very much prefer to see a simple and efficient structure made up of Chairman and a CEO provided with full powers. This, among other things, would allow for timely and clear communication to the market of a new post merger business plan indicating synergies, updated strategy and combined financial targets.

Synergies and value creation options

We calculate NPV of foreseeable cost synergies @€390m, or 14% of post merger market capitalization The merger between Hera and Enìa would create one of Italy’s leading local utility (combined market cap of €2.7b and EBITDA of around €800m in 2009E) and should allow for the creation of operational synergies mainly linked, in our opinion, to improved gas procurement conditions, stronger downstream market positioning supported by cross selling and critical mass, more efficient network management, streamlined business model and capex optimization. On the basis of our preliminary calculation we come up with an NPV of foreseeable cost synergies of €390m, or €0.19 per Hera share and equal to some 14% of the post merger market capitalization. The following table summarizes the underlying logic to our estimated synergies obtained by combining what we see as the three key factors.

Hera – Enìa – Synergies analysis

LEGEND				
	+		7.0%	
	+/-		3.5%	
	-		0.0%	
	-/-		-2.0%	
		Industrial Sense	Geographic Positioning	Governance complexity
Relative weight on total synergies		60%	30%	10%
HERA + ENIA	+/-	+	-	4.2%
HERA + IRIDE	+	+/-	-/-	5.1%
IRIDE + ENIA	+	+	-	6.3%
HERA + IRIDE + ENIA	+	+	-/-	6.1%

Source: Mediobanca Securities

ASSETS



CROSS SYNERGIES

Procurement savings, Cross selling (gas, ele, waste), Waste mix optimization, Heat & Power arbitrage, Multiple disposal choices

Source: Mediobanca Securities

Hera – Enìa – Potential synergies from merger

(€m)	2008E	2009E	2010E	2011E	2012E
Synergies progression		25%	50%	80%	100%
Cost synergies		7	14	23	29
Cost synergies as % of combined EBITDA					3.7%
Total costs		4,246	4,372	4,470	4,532
Cost synergies as % of combined 2009E cost base					0.7%
Cost synergies as % of HERA stand alone 2009E cost base					1.0%
Revenue synergies		6	13	20	25
total revenues		5,019	5,204	5,331	5,448
revenues synergies as % of combined 2009E revenue base					0.5%
revenues synergies as % of HERA 2009E revenue base					0.7%
Capex synergies		3	6	9	12
Normalized CAPEX					236
Capex synergies as % of combined normalized capex					5.0%
total gross synergies		16	33	52	66
<i>Of which Operating synergies</i>		<i>13</i>	<i>27</i>	<i>43</i>	<i>54</i>
total integration costs	-10	-10	-10	0	0
Pre tax synergies	-10	6	23	52	66
tax rate	31%	31%	31%	31%	31%
Net synergies	-7	5	17	39	49
Post tax synergies	-6	4	13	28	351
NPV of post tax synergies	390				
Implied multiple of savings post-tax	8.03				
Implied multiple of savings pre-tax	5.96				
NPV of post tax synergies per Hera share	0.19				
Hera stand-alone PT	3.00				
Combined Entity PT	3.19				

Source: Mediobanca Securities

Operating synergies @ 4.2% of post merger 2009E EBITDA

As illustrated above, we come up with potential operating synergies of around 4% of 2009E combined EBITDA; to this respect we find interesting to note that potential synergies announced on the back of merger deals among Italian local utilities have shown to be anywhere in between 3% and 10% of post merger EBITDA. Needless to say, often promised seldom delivered, we must say with the exception of Hera which shows a reassuring track record on this front.

Announced synergies in local utilities merger deals

	Year	Synergies 100% (€m)	% of combined EBITDA
Hera – Meta Modena	2005	20	5%
ASM Brescia – Bas Bergamo	2005	10	3%
AMGA – AEM Torino	2006	30	10%
AEM Milano – ASM Brescia	2007	110	10%

Source: Mediobanca Securities

Deal EPS accretive starting in 2011 post synergies

Using our synergies forecast and combining our current forecasts on both Hera and Enìa, we estimate the deal to be EPS accretive post synergies starting in 2011.

Hera – Enìa: EPS, CFS accretion / dilution

	2009E	2010E	2011E	2012E
EPS				
Accretion/Dilution pre synergies	-6.1%	-5.9%	-3.7%	-1.3%
Accretion/Dilution post synergies	-3.0%	-0.5%	4.7%	8.1%
CFS				
Accretion/Dilution pre synergies	-3.9%	-4.1%	-3.0%	-1.2%
Accretion/Dilution post synergies	-2.8%	-2.1%	0.0%	2.4%

Source: Mediobanca Securities

Additional synergies could come from new development opportunities

Moreover, we think the deal will offer appealing opportunities for new investments and acquisition of smaller local utilities. To this respect, as illustrated in the following table, we note that an estimated combined Debt/EBITDA ratio of just 2.81 could allow the newco to free up some €540m for potential investments. Applying a 150bps spread over the combined cost of capital of 6.5% translates in a value creation potential of around €125m. Quite clearly, at this stage we have no visibility over the investment strategy post deal (if ever concluded), as such we do not include any development synergies potential in our calculations.

Hera – Enià: Value creation potential from development synergies

	2008E	2009E	2010E	2011E	2012E
Combined Debt	2,109	2,194	2,176	2,088	1,917
ENIA	501	526	568	627	604
HERA	1,608	1,668	1,608	1,461	1,313
Debt/EBITDA	3.01	2.81	2.57	2.35	2.02
Sustainable Debt/EBITDA		3.5			
Potential re-gearing		541			
Spread ROCE/WACC		1.50%			
WACC		6.52%			
Value of development synergies		125			

Source: Mediobanca Securities

Hera + Enià: a pole of attraction for smaller utilities

In our opinion, the new group will work as a new consolidation force for other smaller utilities while also being provided with appealing acquisition opportunities supported by an undergeared balance sheet.

The Italian local utilities M&A drawing board



Source: Mediobanca Securities

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Hera

Profit & Loss account (€ m)	2007	2008E	2009E	2010E
Turnover	3,033	3,224	3,448	3,574
Turnover growth %	31.2	6.3	7.0	3.7
EBITDA	454	532	590	633
EBITDA margin (%)	15.0	16.5	17.1	17.7
EBITDA growth (%)	6.3	17.3	10.9	7.3
Depreciation & Amortization	-233	-234	-249	-260
EBIT	220	298	341	373
EBIT margin (%)	7.3	9.2	9.9	10.4
EBIT growth (%)	-4.8	35.1	14.4	9.4
Net Fin.Income (charges)	-78	-91	-98	-98
Non-Operating Items	0	0	0	0
Extraordinary Items	0	0	0	0
Pre-tax Profit	142	207	242	274
Tax	-33	-85	-99	-112
Tax rate (%)	22.9	41.0	41.0	41.0
Minorities	-14	-16	-17	-17
Net Profit	96	106	126	145
Net Profit growth (%)	6.4	10.6	18.8	15.0
Adjusted Net Profit	70	108	128	147
Adjusted Net Profit growth (%)	-23.3	53.3	18.6	14.8

Balance Sheet (€ m)	2007	2008E	2009E	2010E
Working Capital	120	145	138	125
Net Fixed Assets	3,249	3,428	3,522	3,505
Total Capital Employed	3,369	3,573	3,660	3,630
Shareholders' Funds	1,492	1,513	1,539	1,569
Minorities	47	47	47	47
Provisions	406	406	406	406
Net Debt (-) Cash (+)	-1,424	-1,608	-1,668	-1,608

Cash Flow Model (€ m)	2007	2008E	2009E	2010E
Cash Earnings	329	341	376	406
Working Capital Needs	48	-25	7	13
Capex (-)	-464	-385	-340	-240
Financial Investments (-)	-8	-25	-2	-3
Dividends (-)	-81	-85	-100	-115
Other Sources / Uses	-75	-4	-2	0
Ch. in Net Debt (-) Cash (+)	-251	-184	-60	60

Multiples	2007	2008E	2009E	2010E
P/E Adj.	45.0	18.2	15.3	13.3
P/CEPS	9.6	5.7	5.2	4.8
P/BV	2.1	1.3	1.3	1.2
EV/ Sales	1.5	1.1	1.1	1.0
EV/EBITDA	10.1	6.7	6.1	5.6
EV/EBIT	20.8	12.0	10.6	9.6
EV/Cap. Employed	1.4	1.0	1.0	1.0
Yield (%)	2.6	5.1	5.9	6.9
FCF Yield (%)	<0	<0	3.0	10.0

Per Share Data (€)	2007	2008E	2009E	2010E
EPS	0.09	0.10	0.12	0.14
EPS growth (%)	6.4	10.6	18.8	15.0
EPS Adj.	0.07	0.11	0.13	0.14
EPS Adj. growth (%)	-23.3	53.3	18.6	14.8
CEPS	0.32	0.34	0.37	0.40
BVPS	1.5	1.5	1.5	1.5
DPS Ord	0.08	0.10	0.11	0.13

Key Figures & Ratios	2007	2008E	2009E	2010E
Avg. N° of Shares (m)	1,017	1,017	1,017	1,017
EoP N° of Shares (m)	1,017	1,017	1,017	1,017
Avg. Market Cap. (€ m)	3,162	1,955	1,955	1,955
Enterprise Value (€ m)	4,586	3,563	3,624	3,564
Labour Costs/Turnover (%)	10%	10%	9%	9%
Depr.&Amort./Turnover (%)	8%	7%	7%	7%
Prod. Ratio (Turn./Op.Costs)	1.1	1.1	1.1	1.1
Gearing (Debt / Equity) (%)	93%	103%	105%	100%
EBITDA / Fin. Charges	5.8	5.8	6.0	6.4
Cap. Employed/Turnover (%)	111%	111%	106%	102%
Capex / Turnover (%)	15%	12%	10%	7%
Pay out (%)	85%	94%	92%	92%
ROE (%)	6%	7%	8%	9%
ROCE (%) (pre tax)	7%	8%	9%	10%
ROCE (%) (after tax)	5%	5%	5%	6%

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Profit & Loss account (€ m)	2007	2008E	2009E	2010E
Turnover	1,208	1,462	1,571	1,630
Turnover growth %	-1.5	21.0	7.5	3.7
EBITDA	159	169	184	199
EBITDA margin (%)	13.2	11.5	11.7	12.2
EBITDA growth (%)	10.9	6.1	8.9	8.4
Depreciation & Amortization	-83	-85	-90	-93
EBIT	76	83	94	106
EBIT margin (%)	6.3	5.7	6.0	6.5
EBIT growth (%)	11.5	10.4	12.3	13.3
Net Fin.Income (charges)	-23	-24	-26	-28
Non-Operating Items	1	4	4	4
Extraordinary Items	0	0	0	0
Pre-tax Profit	54	64	72	82
Tax	-24	-25	-30	-34
Tax rate (%)	45.2	39.9	41.7	41.6
Minorities	-2	-2	-2	-2
Net Profit	27	36	40	46
Net Profit growth (%)	0.8	31.8	9.7	15.9
Adjusted Net Profit	27	36	40	46
Adjusted Net Profit growth (%)	0.8	31.8	9.7	15.9

Balance Sheet (€ m)	2007	2008E	2009E	2010E
Working Capital	40	52	31	33
Net Fixed Assets	1,227	1,292	1,352	1,411
Total Capital Employed	1,267	1,344	1,383	1,444
Shareholders' Funds	689	704	716	732
Minorities	11	13	15	17
Provisions	126	126	126	126
Net Debt (-) Cash (+)	-441	-501	-526	-568

Cash Flow Model (€ m)	2007	2008E	2009E	2010E
Cash Earnings	111	121	129	139
Working Capital Needs	-42	-12	21	-1
Capex (-)	-111	-145	-145	-147
Financial Investments (-)	-16	-6	-5	-5
Dividends (-)	-15	-22	-27	-30
Other Sources / Uses	183	2	2	2
Ch. in Net Debt (-) Cash (+)	110	-60	-25	-42

Multiples	2007	2008E	2009E	2010E
P/E Adj.	43.9	18.5	16.9	14.6
P/CEPS	10.9	5.5	5.2	4.8
P/BV	1.7	0.9	0.9	0.9
EV/ Sales	1.1	0.6	0.6	0.6
EV/EBITDA Adj.	8.3	5.1	4.8	4.6
EV/EBIT	17.5	10.2	9.4	8.7
EV/Cap. Employed	1.0	0.6	0.6	0.6
Yield (%)	1.8	4.0	4.4	5.1
FCF Yield (%)	<0	<0	0.5	<0

Per Share Data (€)	2007	2008E	2009E	2010E
EPS	0.25	0.34	0.37	0.43
EPS growth (%)	-18.4	31.8	9.7	15.9
EPS Adj.	0.25	0.34	0.37	0.43
EPS Adj. growth (%)	-18.4	31.8	9.7	15.9
CEPS	1.03	1.13	1.20	1.29
BVPS	6.4	6.5	6.7	6.8
DPS Ord	0.20	0.25	0.28	0.32

Key Figures & Ratios	2007	2008E	2009E	2010E
Avg. N° of Shares (m)	108	108	108	108
EO P N° of Shares (m)	108	108	108	108
Avg. Market Cap. (€ m)	1,201	668	668	668
Enterprise Value (€ m)	1,641	1,169	1,194	1,236
Labour Costs/Turnover (%)	9%	8%	7%	7%
Depr.&Amort./Turnover (%)	7%	6%	6%	6%
Prod. Ratio (Turn./Op.Costs)	1.1	1.1	1.1	1.1
Gearing (Debt / Equity) (%)	63%	70%	72%	76%
EBITDA / Fin. Charges	7.1	7.1	7.0	7.1
Cap. Employed/Turnover (%)	105%	92%	88%	89%
Capex / Turnover (%)	9%	10%	9%	9%
Pay out (%)	79%	75%	75%	75%
ROE (%)	4%	5%	6%	6%
ROCE (%) (pre tax)	6%	6%	7%	7%
ROCE (%) (after tax)	3%	4%	4%	4%