



# Epsilon

## *Case Study*

20 November 2006

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## Meeting Agenda

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### 1. Introduction

- The Investment Banking Activity

### 2. Understanding meeting's objective: Limits of Empiric Methods in Valuing Corporates

- Difference between Empiric and Fundamentals-Based Methods
- Input Required for Valuing Corporates
- Summary

### 3. Analysis of a case study: Epsilon

- Scope of the Work
- Brief Description of Epsilon
- Analysis of Valuation Methods

### 4. Closing Remarks

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# 1. Introduction

*The Investment Banking  
Activity*

# Introduction

## The Investment Banking Activity

BUSINESS MODEL OF AN INTEGRATED INVESTMENT BANK		
ASSET MANAGEMENT	PRIVATE BANKING	INVESTMENT BANKING
<p>Management of business portfolios, mutual funds, and other investment vehicles for a broad spectrum of clients globally ranging from governments, institutions and corporations to private individuals</p> <ul style="list-style-type: none"> <li>▶ Equities</li> <li>▶ Fixed income</li> <li>▶ Commodities</li> <li>▶ Real estate</li> <li>▶ Hedge Funds</li> <li>▶ Private Equity</li> <li>▶ ...</li> </ul>	<p>Provides wealth management products and services for high-net-worth individuals</p> <ul style="list-style-type: none"> <li>▶ Innovative alternative investments</li> <li>▶ Tax planning</li> <li>▶ Pension planning</li> <li>▶ Life insurance solutions</li> <li>▶ Wealth and inheritance advice</li> <li>▶ Establishment of trusts and foundations</li> </ul>	<p>Offers investment banking and securities products and services to meet the needs of institutional clients, companies and government bodies</p> <ul style="list-style-type: none"> <li>▶ CIBD: Advice and execution of M&amp;A transactions, divestments, acquisitions, mergers, takeovers, Management/Leveraged buy-outs, etc</li> <li>▶ ECM: IPOs, Capital increases/secondary placements/block trades, Equity-linked transactions (convertible bonds, exchangeables), private placement of participations in (private) companies, share buybacks, etc.</li> <li>▶ DCM: Plain vanilla financing, liability management advice, structured finance, hedging and derivatives advice</li> </ul>

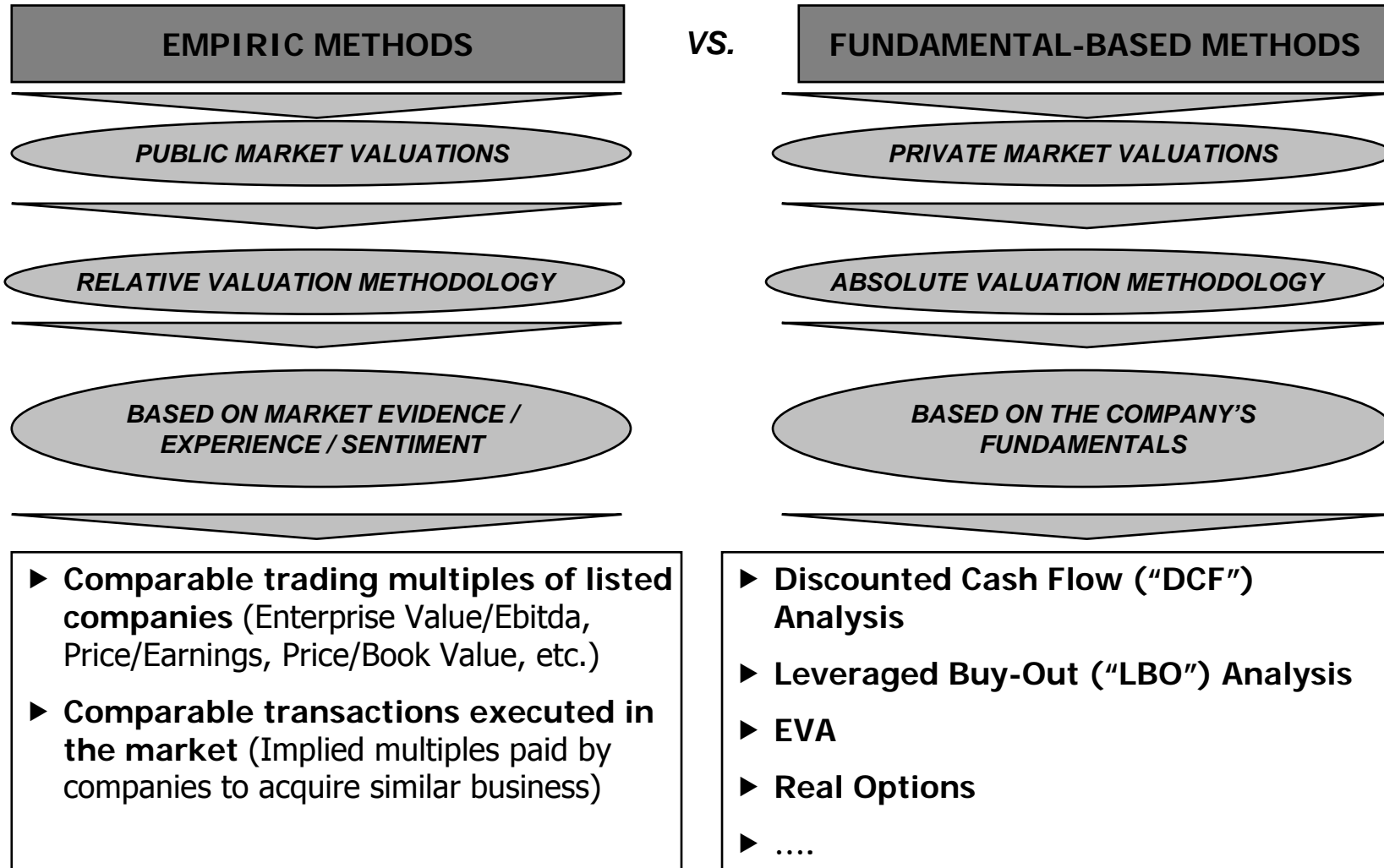
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## **2. Understanding Meeting's Objective**

*Limits of Empiric Methods  
in Valuing Corporates*

# Difference between Empiric and Technical Methods

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# Input Required for Valuing Corporates

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## EMPIRIC METHODS

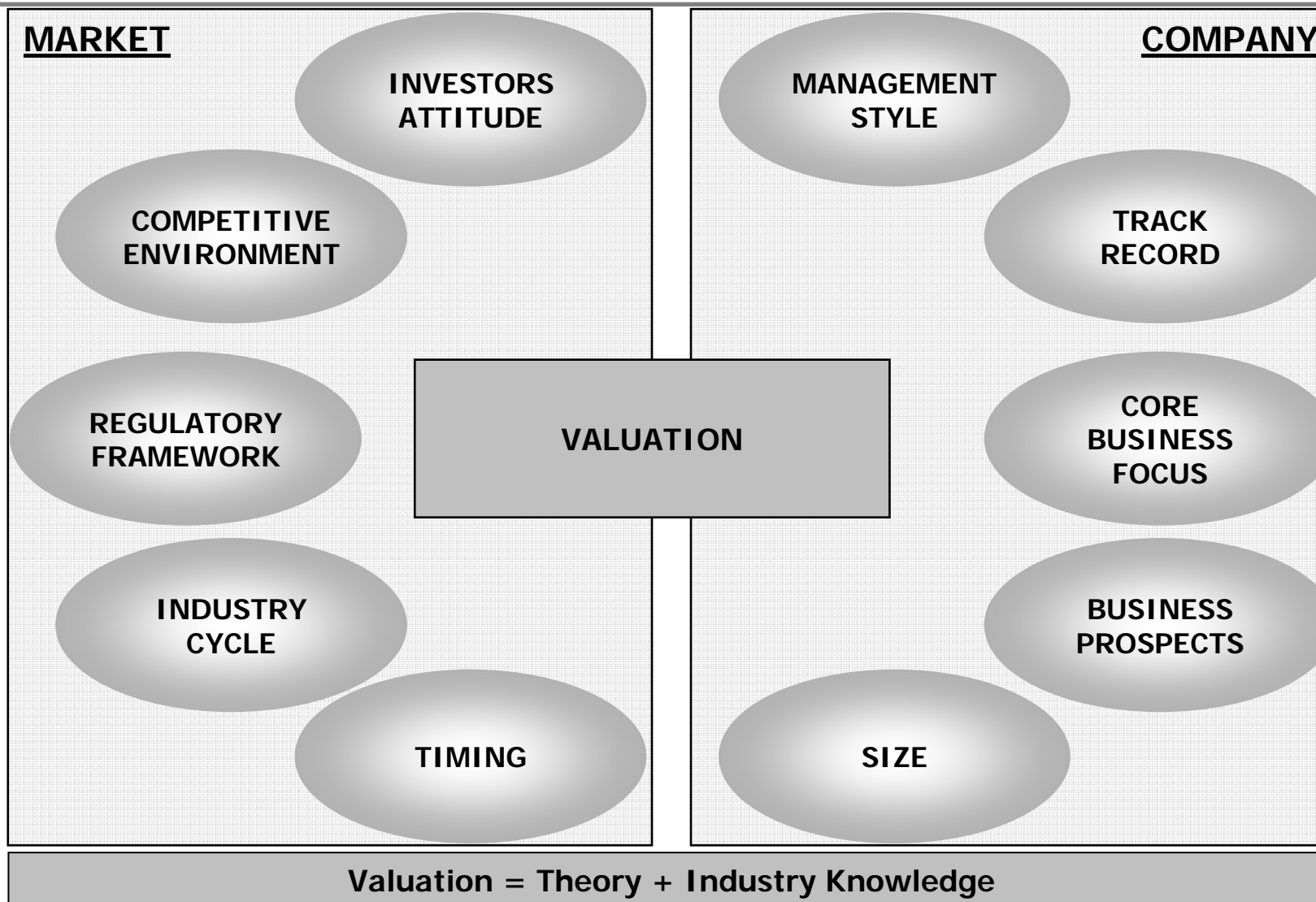
- ▶ **For trading multiples, identification of comparable companies**
  - Size
  - Similar operating and financial characteristics
  - Industry
  - Business prospects
- ▶ **For comparable transactions, understanding of the offer structure and conditions**
  - Hostile/Friendly
  - Minority/Majority
- ▶ **Definition of appropriate valuation benchmarks and multiple range**

## FUNDAMENTAL-BASED METHODS

- ▶ **Good understanding of the company needed**
  - Sales/earnings projections
  - Cash flow dynamic
  - Balance Sheet
- ▶ **Realistic assumptions**
  - Discount rate
  - Perpetual growth rate
  - General market evolution

The real risk of any valuation is: "Garbage In → Garbage Out"

# Summary





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### **3. Analysis of a Case Study**

*Epsilon*

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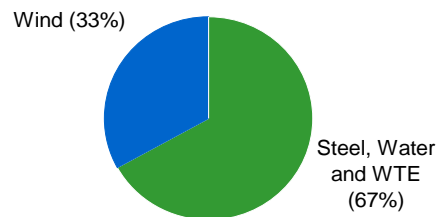
## **3.1 Introduction to Epsilon**

# Brief Description of Epsilon

- ▶ After a strategic review, in 2005 Epsilon decided to focus on the wind energy business and to exit the steel trading and the waste/waste-to-energy business
- ▶ As of today, Epsilon is (almost) a pure wind energy player
- ▶ Epsilon is implementing a strong investment plan in the wind business (~ € 380 mn) to broaden the existing asset base of 77 MW to 350 MW by 2009

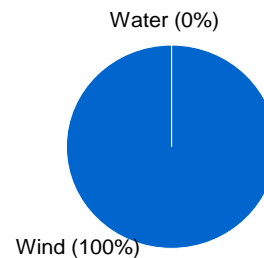
## 2005 EBITDA

€ 29mn



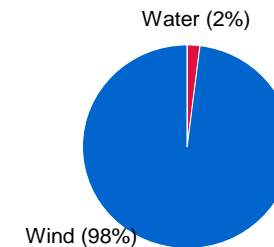
## 2005 PRO FORMA EBITDA<sup>(1) (2)</sup>

€ 10mn



## 2009E EBITDA<sup>(1)</sup>

~€ 100 mn



(1) Gross of corporate costs

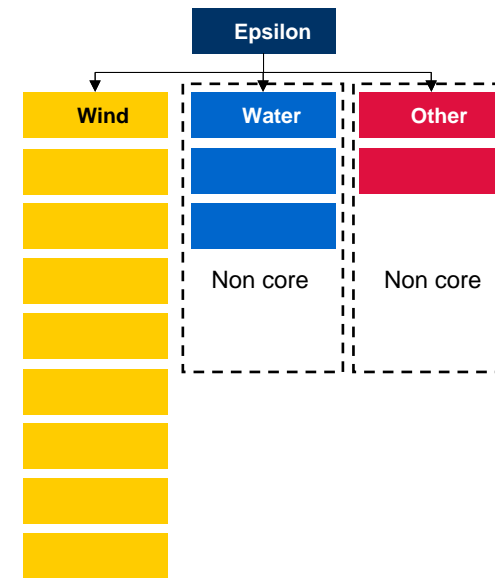
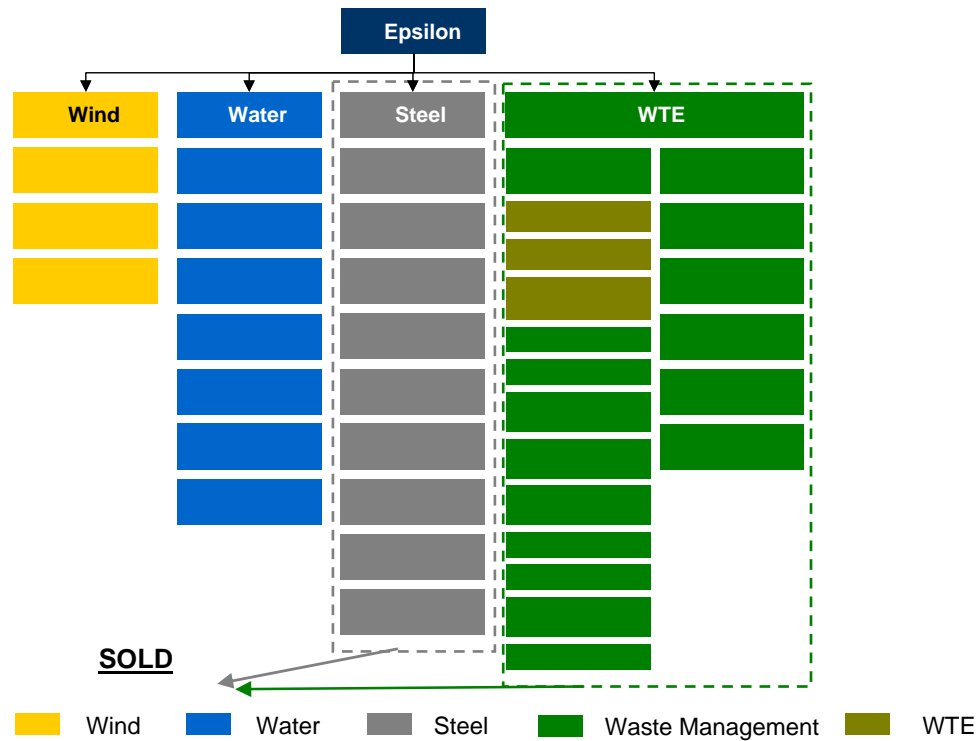
(2) After disposal of the steel and waste-to-energy business

**Epsilon is the one of the largest wind energy player in Italy**

# Brief Overview of Epsilon

**MAY 2004**

**JULY 2006**

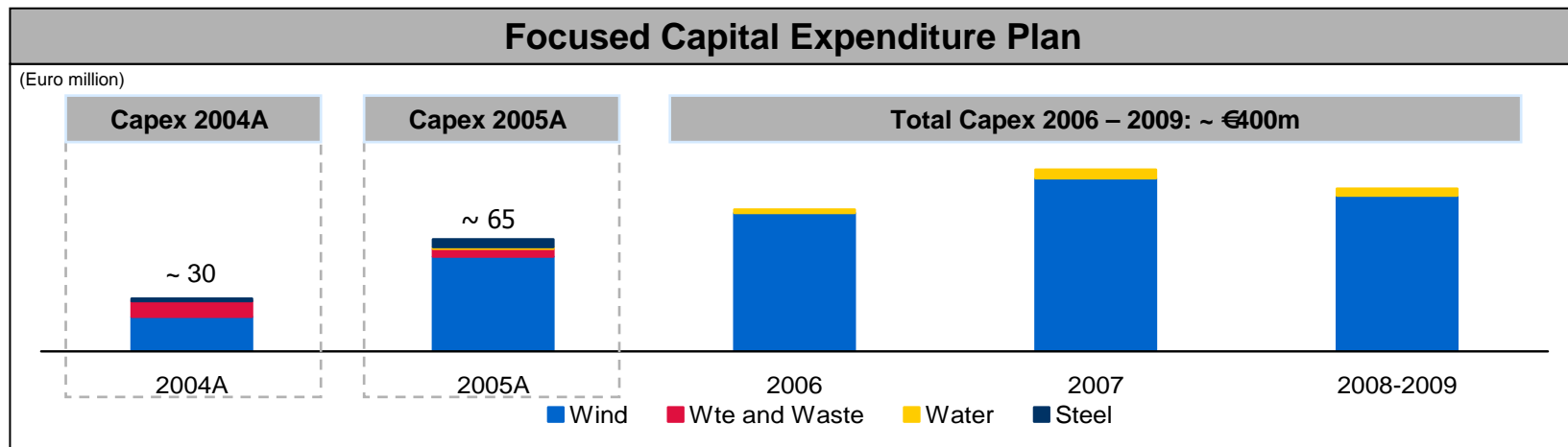
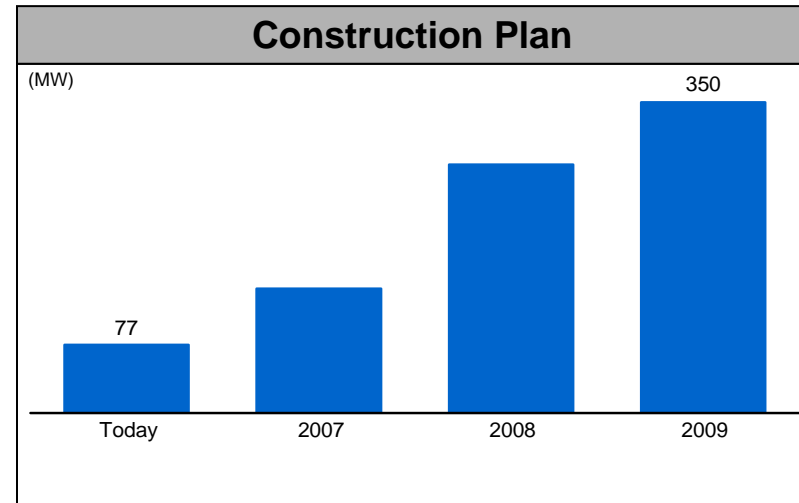
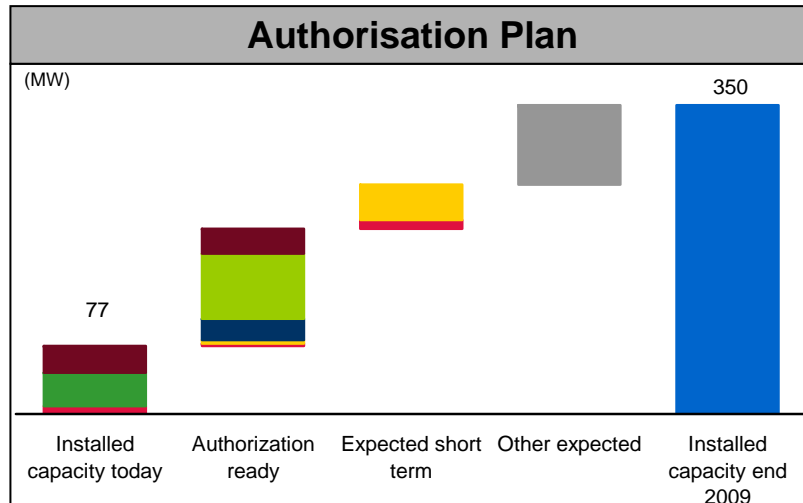


**In the last two years the company has completed a business restructuring to focus on wind electricity generation only**

# Financial Highlights

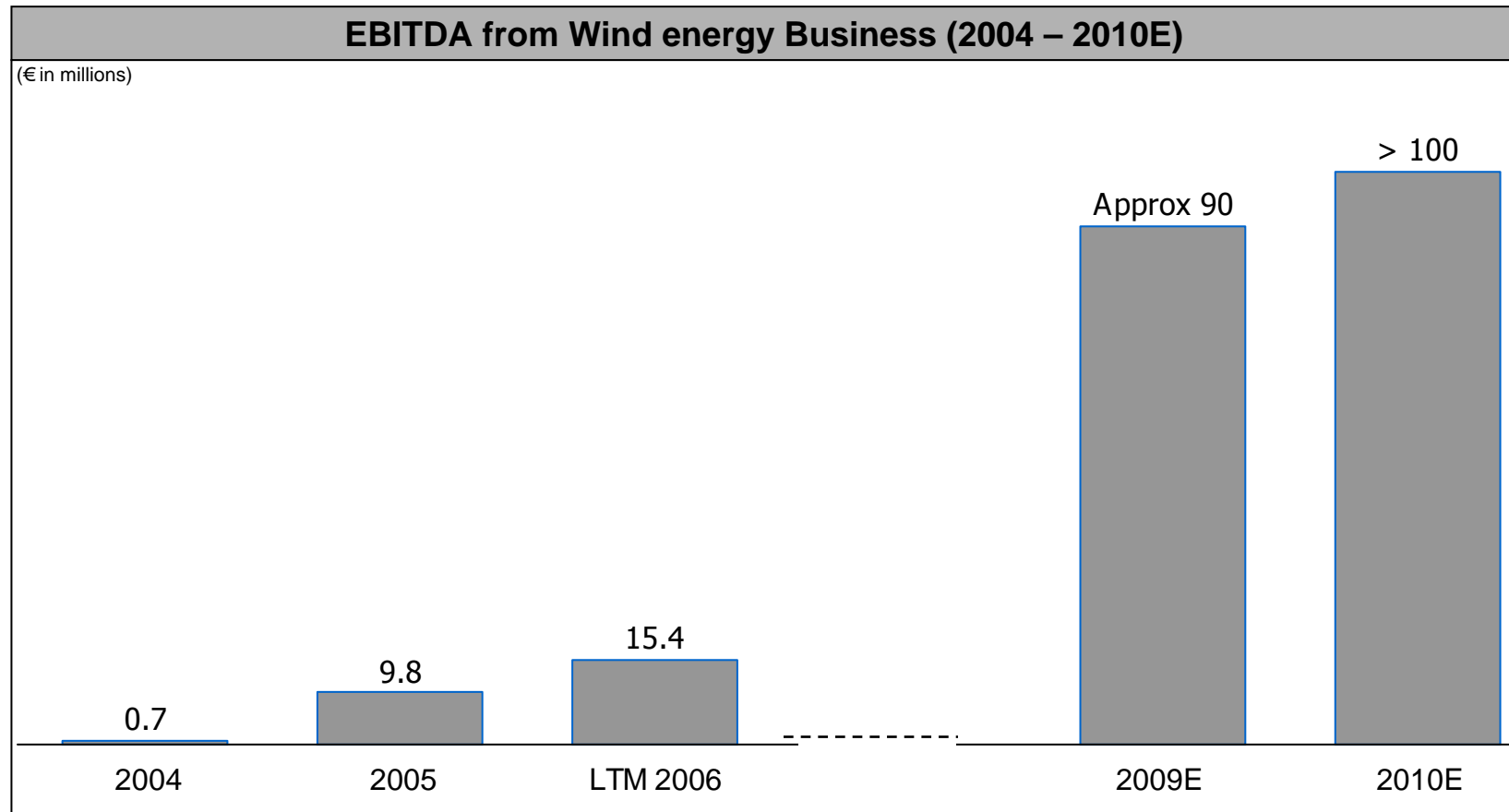
<i>€ mn</i>	2002	2003	2004	2005	Capitalization Table	
<b>Revenues</b>	<b>84</b>	<b>238</b>	<b>284</b>	<b>293</b>	<b>Share price</b>	<b>€ 3.33</b>
Steel	57	178	224	224	Shares outs. (# mn)	94.9
WTE	–	24	26	34	<b>Market Capitalization</b>	<b>316</b>
Wind	–	0	1	12	Net Debt as of Sept 30, 2006	(10.0)
Other	27	36	33	23	Minorities	–
<b>EBITDA</b>	<b>–</b>	<b>36</b>	<b>28</b>	<b>34</b>	<b>Enterprise Value</b>	<b>306</b>
Steel	–	13	24	15		
WTE	–	14	8	13		
Wind	–	0	1	10		
Other	–	8	(5)	(4)		
<b>Net Income</b>	<b>4</b>	<b>5</b>	<b>(24)</b>	<b>(12)</b>		
Sh. Equity	82	113	169	152		
Net Debt	163	179	153	236		
<b>Net Invested Capital</b>	<b>245</b>	<b>292</b>	<b>321</b>	<b>387</b>		
						<b>Asset disposals</b>

# Expected Evolution of the Installed Capacity



- ▶ Nearly 100% of total capex will be employed in wind energy projects
- ▶ Capex in Wind projects will be financed by Project Financing with an average leverage D/E of 75/25

# Expected EBITDA Evolution



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## 3.2 Valuation of Epsilon



# Scope of the Work

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## ▶ Exercise

- Valuation of Epsilon S.p.A. ("Epsilon" or the "Company"), a listed company trading on the MTA segment of the Italian Stock Exchange

## ▶ Background

- Ester S.p.A. ("Ester") launched a voluntary tender offer ("VTO") on the 100% of Epsilon at a price of € [●] per share
- We have been asked by the Board of Directors ("BoD") of Epsilon to provide our opinion in relation to the valuation of the 100% of ordinary share capital of the Epsilon in the context of the VTO launched by Ester

### Before entering the valuation exercise, ask yourself:

- Who is your client: the BoD of Epsilon, the majority shareholder, the minority shareholders, the stakeholders, the buyer, ...?
- The valuation perspective: Buyer's or Seller's perspective? Should I consider the synergies?
- Your goal: shall I provide a *valuation* opinion or a *fairness* opinion ?

#### WHAT WE WILL DO...

- ▶ Work for the Board of Directors of Epsilon
- ▶ Provide a *valuation opinion*
- ▶ Value Epsilon on a stand-alone basis

#### ...AND WHAT WE WON'T

- ▶ Opine on the control premium
- ▶ Judge about the "fairness" of the offer
- ▶ Express our view about synergies

# Valuation Approach

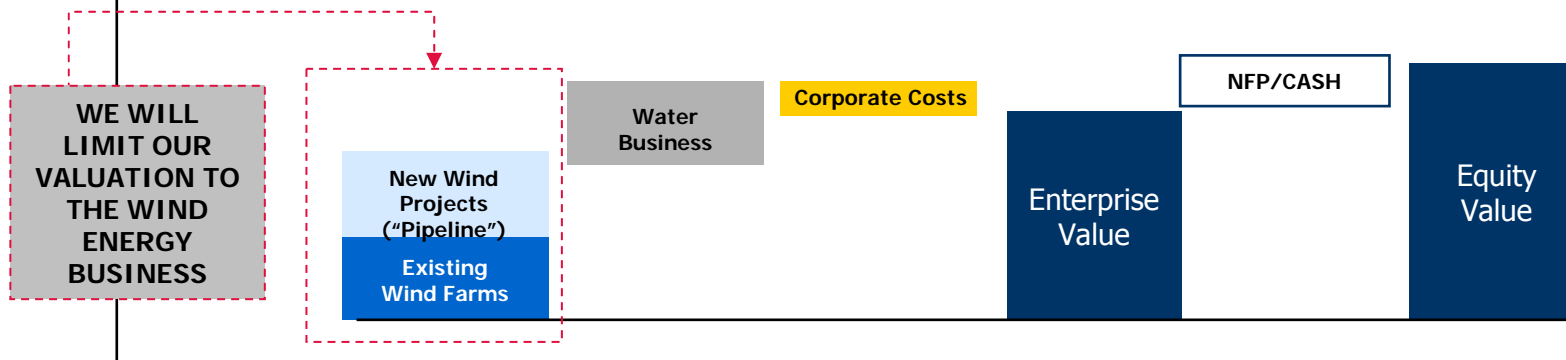
## WHAT WE SHOULD DO...

- ▶ **First, test the relevance of trading price and industry fundamentals**
- ▶ **Then,**
  - decide the valuation approach
  - select our primary valuation method
  - choose valuation methods for "sanity checks"
- ▶ **Finally, verify valuation against trading price**

## ...AND HOW WILL WE PROCEED

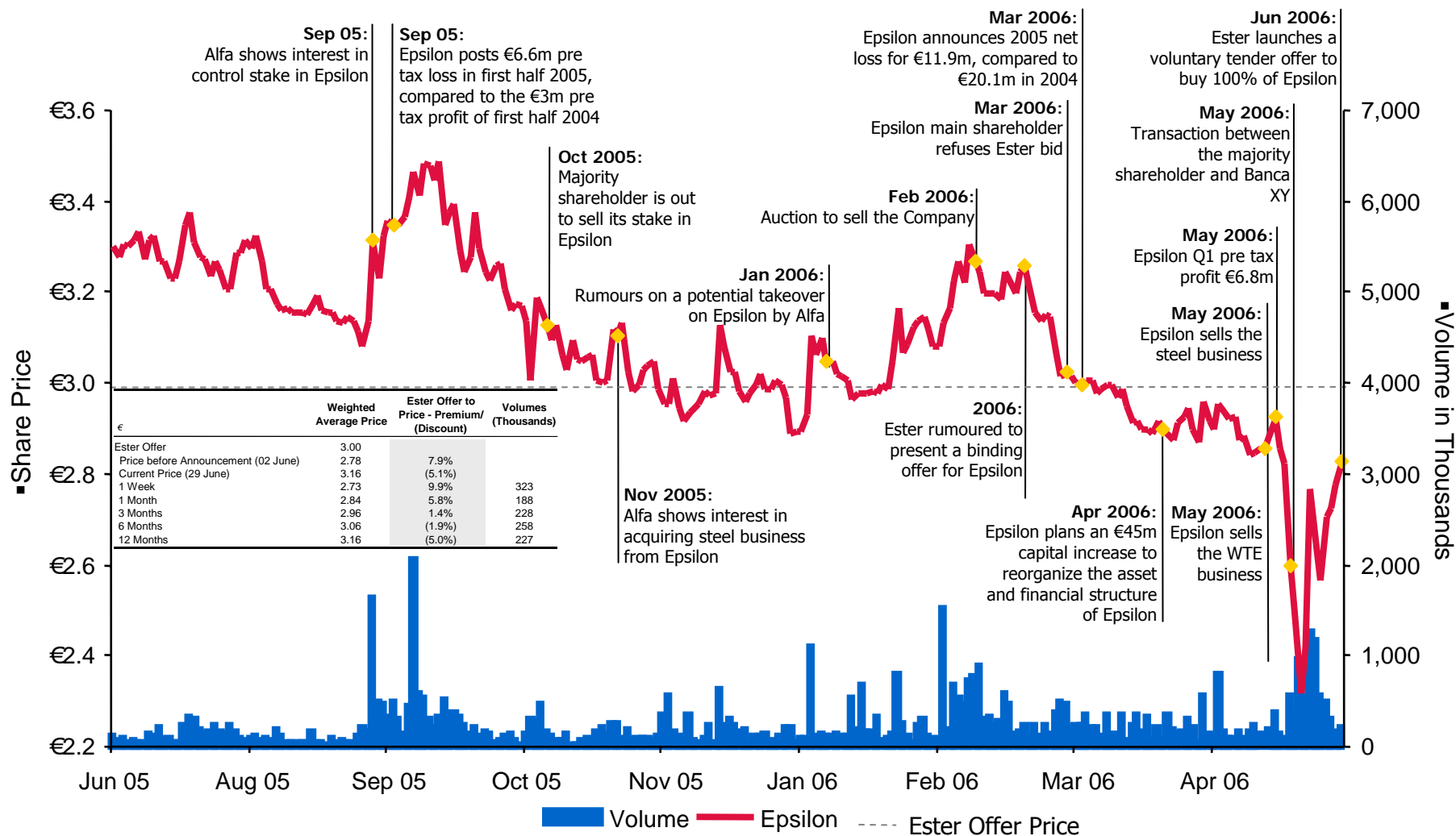
- ▶ We will look at Epsilon's trading price
- ▶ We will value Epsilon's wind energy business with empirical methods
- ▶ We will debate about valuation with DCF/other methods

## PREFERRED VALUATION APPROACH: SUM-OF-THE PARTS VALUATION



# Valuation of Epsilon

## LTM Share price until Ester's offer



# Valuation of Epsilon

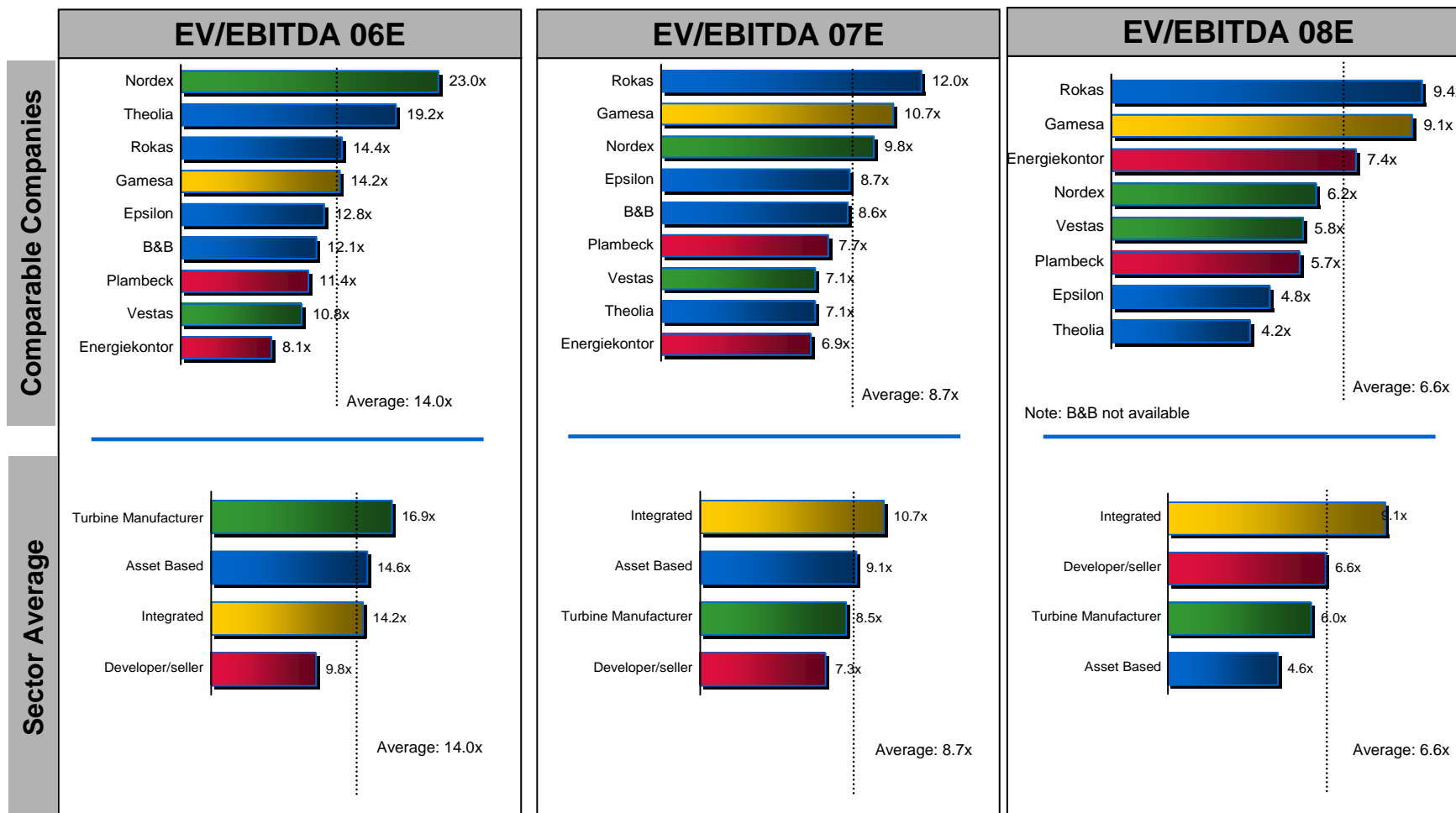
## Considerations About the Relevance of the Share Price

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- ▶ Before the sale of the steel and WTE business (April-May 2006), Epsilon was a low-attractive conglomerate
  - Limited size
  - Non-synergistic activities
  - Non-energy business overwhelming
- ▶ Financial restructuring ongoing
  - Capital increase are perceived as a signal of financial weaknesses if not related to specific events
- ▶ Failed auction(s) to sell the Epsilon increased investor's concerns about quality of the assets
  - Why many companies pulled out after due diligence?
- ▶ Poor liquidity of the shares
- ▶ Shareholders' agreement in place

**Epsilon's share price may not be a good indicator of the "fair value" of Epsilon**

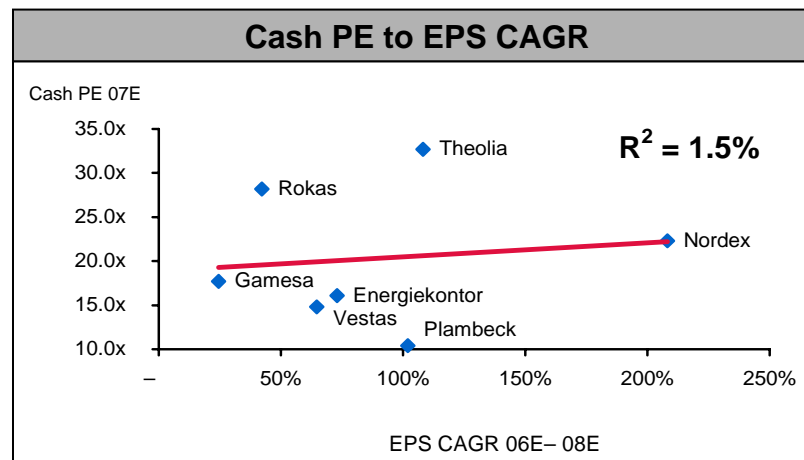
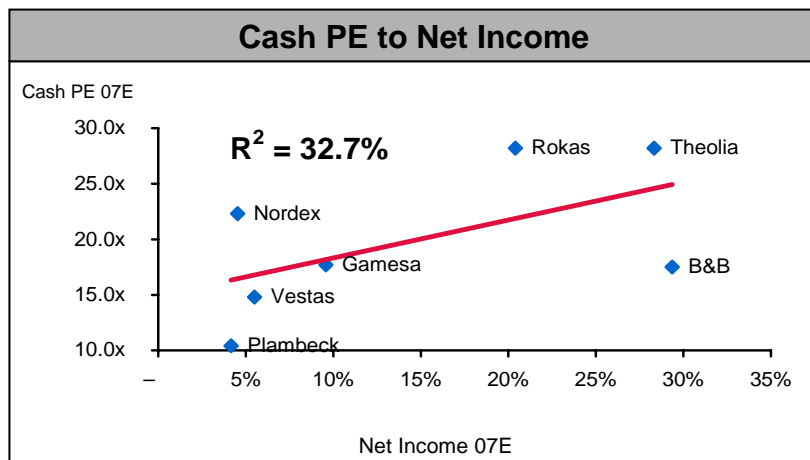
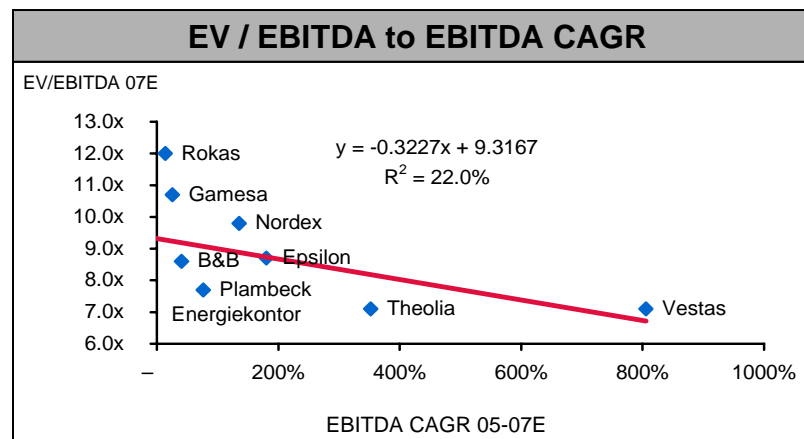
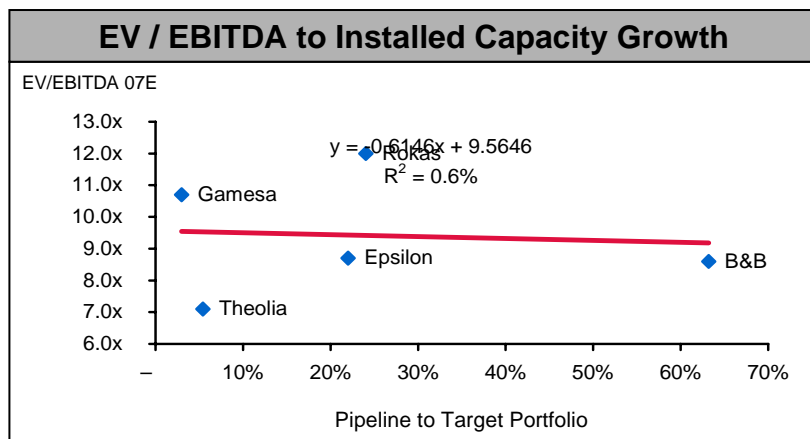
# Valuation of Epsilon's Wind Energy Business Implied Industry Trading Multiples



Source: Brokers research

**P/E cannot be used as many companies have negative earnings. With respect with EV/Ebitda, however, our panel shows a broad range of valuation multiples**

# Valuation of Epsilon's Wind energy Business Implied Industry Trading Multiples

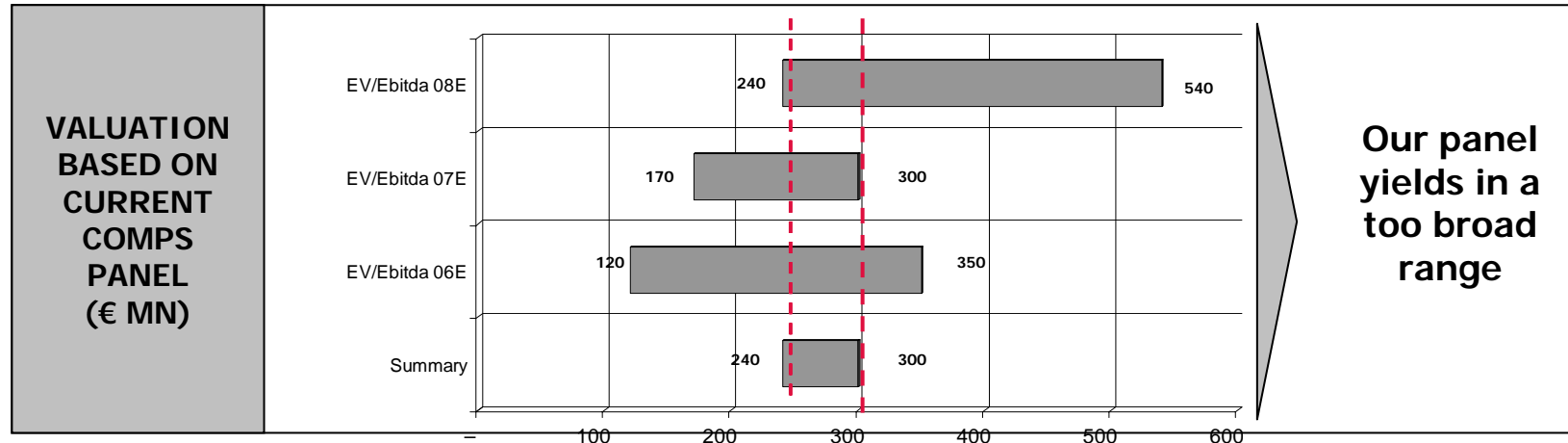


**No significant correlation across valuation drivers**

# Valuation of Epsilon's Wind Business

## Selection of Closest Comparable Companies

- ▶ The analysis of comparable companies results in a wide range of implied trading multiples
- ▶ Scarce correlation across current share price and business perspectives
- ▶ Reason for this are mainly due to
  - lack of pure wind power generation producers
  - scarce coverage by equity analysts
  - differences in the regulatory environment in which these companies operate
  - differences in the start-up of new wind farms
  - poor liquidity of shares



However, our task requires us to verify public market valuations. We therefore have to identify the closest comparable companies to Epsilon

# Valuation of Epsilon's Wind Business

## Selection of Closest Comparable Companies

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- ▶ We exclude Nordex and Vestas (wind turbine producers)
- ▶ We exclude Gamesa
  - Integration across the value chain (production of wind turbine generators and operations of wind farms) thus hedging margins/gains
  - Worldwide player (diversification of both operational and regulatory risk)
  - Large market capitalization (different investors' base)
- ▶ We exclude Babcock&Brown Wind Energy Partners
  - Operates as a private equity
  - Worldwide player (diversification of both operational and regulatory risk)
  - First-class asset quality (more than 2,600 working hours/year vs. Epsilon's 2,000)
- ▶ We exclude Plambeck and Energiekontor
  - Limited market size

**Closest comparable companies were identified in Theolia (France) and Rokas (Greece)**



# Valuation of Epsilon's Wind Business

## Selected Comparable Companies

- We base our valuation on 2008 implied multiple to take account of the growth rate of such companies, and of Epsilon, expected over the next two years

Installed Capacity (MW)	2005	2006	2007	2008
Theolia	74	100	250	400
Rokas	193	220	291	398
Epsilon	77	n.a.	140	280

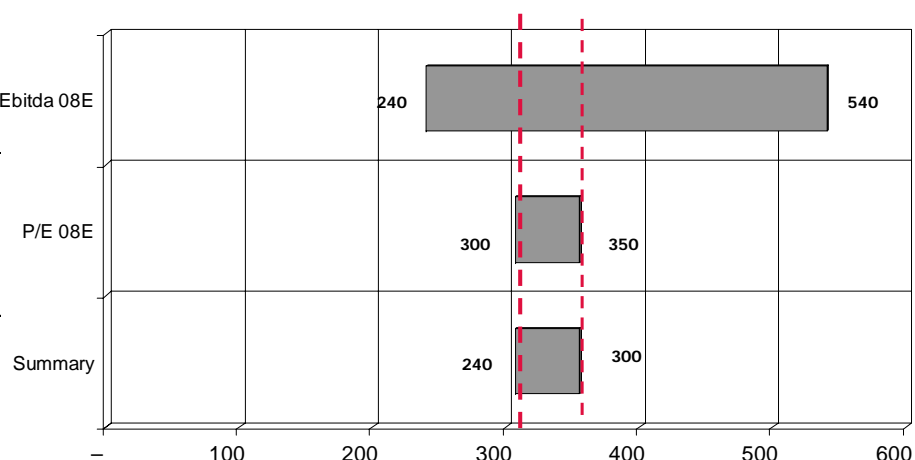
Ebitda (€ mn)	2005	2006	2007	2008
Theolia	-	4	23	51
Rokas	29	35	46	63
Epsilon	n.a.	n.a.	n.a.	n.a.

Ebitda Margin	2005	2006	2007	2008
Theolia	-	12%	27%	44%
Rokas	53%	63%	71%	77%
Epsilon	n.a.	n.a.	n.a.	n.a.

Net Income (€ mn)	2005	2006	2007	2008
Theolia	-	-	5	11
Rokas	9	9	14	20
Epsilon	n.a.	n.a.	n.a.	n.a.



**EV/EBITDA still yields in a too broad range, whilst P/E appears to be more aligned with trading price**

# Brokers' View on Epsilon

Date	Broker	Recommendation	Target Price (€)	Premium / (Discount) to Current Price
Date	Broker 1	na	3.5	12.9%
Date	Broker 2	<b>BUY</b>	3.8	22.2%
Date	Broker 3	<b>HOLD</b>	3.4	9.3%
Date	Broker 4	na	3.3	6.1%
<b>Average</b>			<b>3.5</b>	<b>12.6%</b>

"[...] We confirm our BUY rating due to the higher visibility on the wind plant and consequently on FCF generation. We therefore suggest not to deliver the shares to Ester's tender offer (at €3.0) [...]". (Broker 1)

"[...] Assuming full implementation of the business plan, the value creation is around € 0.30 per share on Epsilon. That could be the reason for an increase of the offer up to €3.3 per share by Ester. Furthermore this option seems to be hypothetical, while in case of a success of the VTO at actual offer price would create a value of €0.20 per share (1% of TP) [...]". (Broker 4)

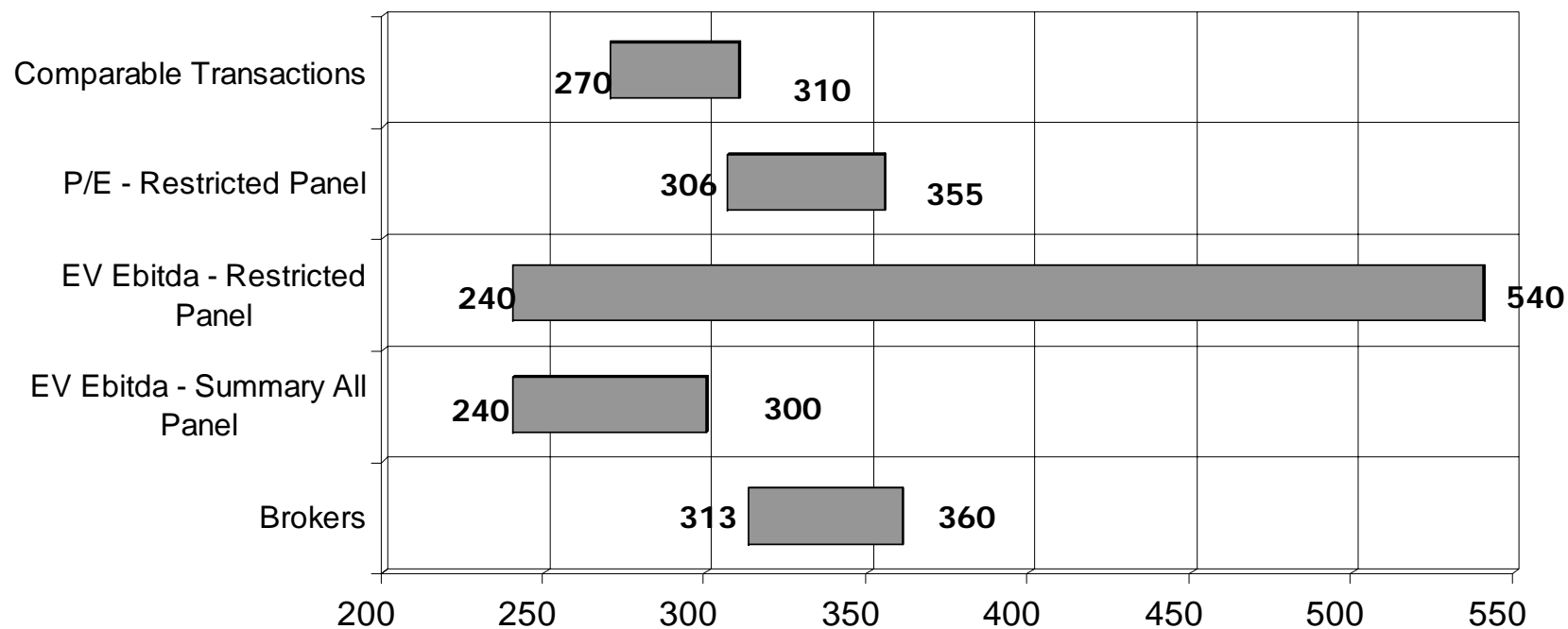
"[...] Our recommendation at €3.4 per share is confirmed, thanks also to a more aggressive capex plan. [...] Possibility of an increase in the offer price by Ester, the strategic partner, or by other operators [...]". (Broker 3)

"[...] Ester's VTO price (€3.00 per share) implies a 17% discount to Epsilon's fair value [...]". (Broker 2)

**Following the presentation of the new business plan, brokers' target price ranges from €3.3 up to €3.8 per share. Broker's average target price implies a 12.6% premium on current price**

# Valuation Summary

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**Would you tender your shares on the basis of this valuation ?**

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## 4. Closing Remarks

# Key Take Away Points

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- ▶ Public market valuations reflect the current outlook of the market on the sector. Depending on situations, public comps may serve as primary or secondary valuation method, i.e.
  - IPO and ECM transactions: primary method
  - Private M&A transactions: secondary method
  - Merger of Equals: primary method
- ▶ Public market valuations require, however, certain conditions to be applicable
  - Existing set of comparable companies
  - Coverage by research analysts
  - Similar expected performance and margins
- ▶ The market price may not adequately measure the value of a company
  - In case of Epsilon, it was distorted by prolonged concern about the financial situation and auctions on the controlling stake/assets

**DCF is the most reliable valuation method for the wind business, as it captures all the value drivers. Comparable companies/transactions provide a useful crosscheck but are not used as valuation methodologies in the industry**