

Veolia

Closing the Circular Economy loop – Resume at Buy

Resuming Coverage BUY | PO: 38.00 EUR | Price: 29.05 EUR

Still an underappreciated story; 35% TSR

We resume coverage of Veolia at Buy (€38 PO). Our investment case is predicated on: (1) supportive EU legislation triggering demand for more value-added treatment of waste; (2) better margins on a 2-3 year view thanks to synergies, softer competition, greater share of high-value added solutions provided; and (3) resilient waste recovery and water pricing even if macro cycle slows down as our strategists expect. We flag new regulation and a successful equity raise as short-term catalysts; and a likely CMD in 2H22.

EU policymakers have a busy calendar this autumn

European legislators are due to release a wave of stricter regulations for waste treatment over the next 12 months. Two key documents are due before year end: the EU's first Sustainable Product policy and a revision of rules on waste shipments. We think updated regulations could offer a secular growth opportunity – greater volumes and demand for recycling and waste treatment – for Veolia over the next decade.

3 reasons to expect better margins on a 2-3 year view

Aside from new EU regulation: (1) acquisition of Suez removes one of Veolia's main competitors – better renewal rates and pricing terms could follow; (2) the €500m synergies target seems reasonable vs comparable M&A transactions; (3) attractive growth in complex, high margin solutions (e.g. plastic recycling and hazardous waste) driven by consumer preferences and growing relevance of ESG in corporate strategy.

Ahead of consensus on strong waste performance '22/23

Our positive outlook on EU waste and hazardous waste puts us c1% ahead of 2022/23 consensus on revenue, +2%/+4% ahead on EBITDA (+50bps on margin) and +11%/+15% on net income. Our €38 PO values Veolia at 7.5x EV/2022E EBITDA, still undemanding vs. peers (Clean Harbors on 10.5x, Biffa 9.0x) and the broader DJ US waste index (c14x).

Estimates (Dec) (EUR)	2019A	2020A	2021E	2022E	2023E
EPS (Adjusted Diluted)	1.31	0.72	1.35	1.93	2.44
EPS Change (YoY)	12.5%	-45.5%	88.6%	42.8%	26.7%
Dividend / Share	0.50	0.70	1.00	1.15	1.30
ADR EPS (Adjusted Diluted - US\$)	1.47	0.82	1.59	2.27	2.88
ADR Dividend / Share (US\$)	0.56	0.80	1.18	1.36	1.53
Valuation (Dec)					
P/E	22.1x	40.6x	21.5x	15.1x	11.9x
Dividend Yield	1.72%	2.41%	3.44%	3.96%	4.48%
EV / EBITDA*	7.81x	8.63x	7.60x	4.59x	4.22x
Free Cash Flow Yield*	NA	NA	NA	NA	NA

* For full definitions of *Qmethod*SM measures, see page 19.

01 September 2021

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Stock Data

Price (Common / ADR)	29.05 EUR / 33.98 USD
Price Objective	38.00 EUR / 44.80 USD
Date Established	1-Sep-2021 / 1-Sep-2021
Investment Opinion	B-1-7 / B-1-7
52-Week Range	15.68 EUR-29.27 EUR
Market Value (mn)	16,837 EUR
Shares Outstanding (mn)	579.6 / 579.6
Average Daily Value (mn)	38.17 USD
Free Float	90.1%
BofA Ticker / Exchange	VEOEF / ENP
BofA Ticker / Exchange	VEOEY / NYS
Bloomberg / Reuters	VE FP / VIE.PA
ROE (2021E)	10.8%
Net Dbt to Eqty (Dec-2020A)	169.7%
ESGMeter SM	High

ESGMeter is a proprietary metric based on quantitative analysis and fundamental analyst inputs that reflects our assessment of a company's ESG-related attributes. It is intended to indicate a company's likelihood of experiencing stronger financial stability (higher ROE and lower earnings and price volatility) over the next three years relative to its peer group. There are three ESGMeter levels – Low, Medium, and High. Refer to "BofA ESGMeter Methodology". ESGMeter is not intended to be indicative of a company's future stock price performance and is independent of the BofA Global Research fundamental equity analyst's investment rating, volatility risk rating, income rating or price objective for that company.

DJ US waste index: Dow Jones US Waste & Disposal Services Index (Bloomberg ticker DJUSPC Index)

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Refer to important disclosures on page 20 to 23. Analyst Certification on page 17. Price Objective Basis/Risk on page 17.

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Timestamp: 01 September 2021 12:00AM EDT

Stricter EU regulation offers new opportunities in waste

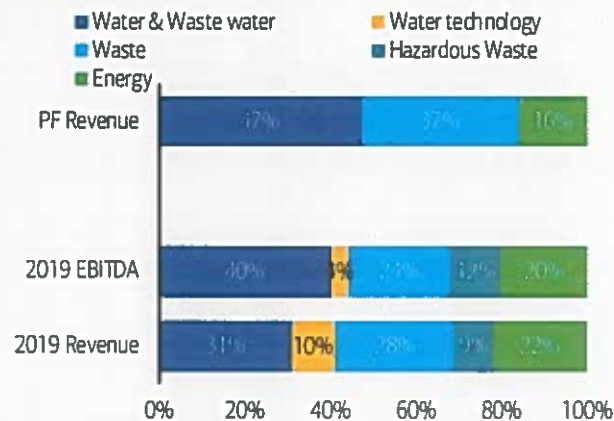
Establishing a circular economy was one of the key pillars of the Green Deal introduced by the European Commission in December 2019. Since then, policymakers have started working on new policies to align Europe's path with that long-term vision. **We believe those efforts will result in stricter regulations for waste treatment, providing a long-term secular growth opportunity for Veolia and other waste companies.** In particular, we think they may be able to benefit from:

1. A reduction in disposed waste and greater volumes of waste treated and recycled – a more profitable activity for waste companies
2. Lower recycling costs due to standardisation/labelling of materials and economies of scale of existing sorting capacity
3. Stronger demand for recycled materials due to minimum recycled content requirements and raw material inflation

Veolia generates ~35% of its EBITDA from waste activities, with a particularly strong presence in hazardous waste.

Exhibit 1: Revenue and EBITDA split for Veolia, standalone as of 2019 and Pro-forma 2019 for Suez acquisition

Waste represents ~35-40% of Veolia's revenue and EBITDA, with Hazardous waste being ~10-12% as of 2019

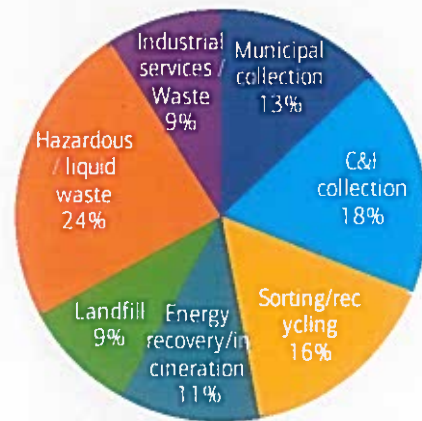


Source: company presentation

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Exhibit 2: Veolia's waste revenue split by activity as of 2020

Hazardous waste represents around a quarter of Veolia's waste revenue, while landfill's share is below 10%



Source: company presentation

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How barriers are being addressed by policy

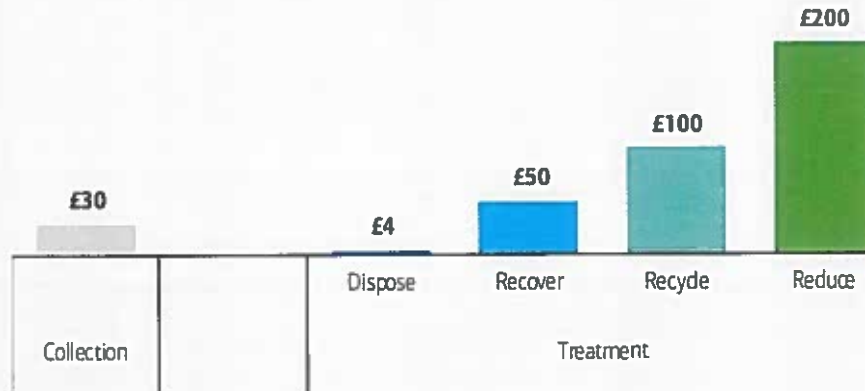
Analysis presented by the European Environmental Agency and other environmental groups has outlined several barriers to a more circular economy. These barriers are being directly addressed as part of the EU Circular Economy action plan, adopted by both the European Commission and Parliament.

1. **The complex and unsorted composition of waste streams** prevent the optimal treatment of specific types of material (e.g. different types of plastics) and lowers the overall volume and quality of the recycled product.
- This issue will be addressed as part of the Sustainable Product initiative. This revision plans to make products and packaging easier to recycle by introducing greater standardisation requirements and better labelling to ease separation.



Exhibit 3: Biffa's indicative adjusted EBIT per tonne (£)

Recovery, recycling and reduction/redistribution provide better margins for waste companies versus disposal



Source: Biffa's FY21 results presentation

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- It also includes legislation on batteries, packaging, end-of-life vehicles, and hazardous substances in electronic equipment, aiming to prevent waste, increase recycled content, and promote cleaner waste streams.
2. **Lack of demand for recycled materials and cost disadvantage vs raw materials.**
 - Also part of the Circular Economy package is a Sustainable Product Policy initiative. This document would introduce minimal requirements for recycled content in products and packaging, thus supporting demand for these materials. Furthermore, we believe the ongoing inflation in raw materials can contribute to reduce their relative cost advantage over recycled products.
 3. **The use of hazardous chemicals in products, which prevents their recycling.**
 - Policymakers have set out plans to promote replacing hazardous chemicals in consumer products with safer alternatives (New Chemicals Strategy).
 4. **Exports of waste outside of Europe.** The EU waste shipment law prohibits the export of hazardous waste and waste destined for disposal to non-OECD countries. Yet, Europe exported around 33 million tons of waste in 2020, equivalent to 4% of its non-mineral waste or 13% of its municipal waste.
 - The EU is currently due to publish an updated waste shipment regulation, following a consultation period. We expect further restrictions to exports of waste that can be treated domestically within the EU, potentially resulting in greater waste volumes processed and recycled domestically.
 - The EU has already imposed a prohibition to export low quality plastics outside the OECD as of January 2021.

Another area where the EU rules could tighten is municipal waste. Several countries are at risk of missing the 2020 target of a 50% recycling rate. Also, while landfill rates have decreased in line with the EU's expectations, part of those volumes are now incinerated instead, leaving a larger carbon footprint per MWh than coal generation. We expect the EU to dis-incentivise incineration and to potentially introduce faster adoption of higher recycling rates of municipal waste. Studies have shown that this waste stream is up to 80-90% recyclable, compared to a -45-50% rate today.

See next section for implications on Veolia's revenue and margins.

EU's current targets on waste generation and recycling are:

- Less than 10% of municipal waste deposited in a landfill by 2035 (vs c25% today)
- Significant reduction of waste generation by 2035
- 50% reduction in residual municipal waste by 2035
- A ban on exports of unsorted or low-quality plastic waste to non-members of the OECD group as of 1 January 2021
- Common EU target for recycling at least 55%/60%/65% of municipal waste by 2025/30/35
- Common EU target for recycling 65%/70% of packaging waste by 2025/30 based on the following separate targets for specific materials (see exhibit below)

Exhibit 4: Planned adoption date for several initiatives under the Circular Economy action plan
 The bulk of actions under the Circular Economy plan will be drafted over the next 12-18 months

Legislative proposal for a sustainable product policy initiative	2021
Review of the rules on end-of-life vehicles	2021
Review to reinforce the essential requirements for packaging and reduce (over)packaging and packaging waste	2021
Mandatory requirements on recycled plastic content and plastic waste reduction measures for key products such as packaging, construction materials and vehicles	2021 / 22
Waste reduction targets for specific streams and other measures on waste prevention	2022
EU-wide harmonised model for separate collection of waste and labelling to facilitate separate collection	2022
Revision of the rules on waste shipments	2021
Legislative proposal on substantiating green claims	2021

Source: European Commission

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Exhibit 5: Common EU target for recycling for specific materials

65%/70% of EU packaging waste to be recycled by 2025/30

	By 2025	By 2030
All packaging	65%	70%
Plastic	50%	55%
Wood	25%	30%
Ferrous metals	70%	80%
Aluminium	50%	60%
Glass	70%	75%
Paper and cardboard	75%	85%

Source: European Commission

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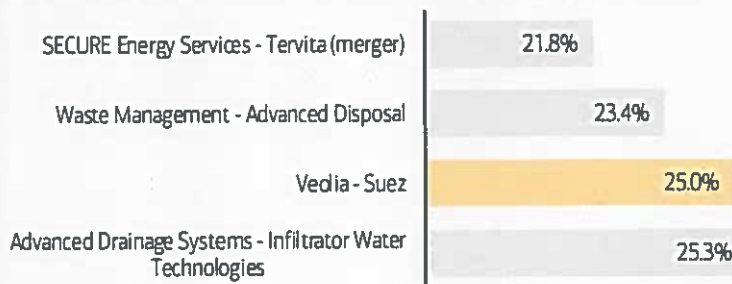
3 reasons for potential margin expansion

We believe Veolia’s margins could structurally improve on a 2-3 year view on top of the potential boost coming from new EU regulation. In our view:

1. It will absorb Suez upon completion, one of its main competitors for contracts across multiple water and waste markets. While Suez remains a competitor in France (as per anti-trust remedies, see details in section *Recap of Veolia’s acquisition of Suez*), the deal should alleviate pricing pressure on Veolia’s future contract bidding and renewals in other overlapping markets.
2. The guided €500m annual cost synergy estimate seems reasonable in the context of significant operational and regional overlap between both entities. Potential savings as a percentage of acquired EBITDA (c25%) are also consistent with recent deals in the broader waste and water tech sector at c20-25%. Since Suez’s French assets will be sold as part of the deal, we think synergies would mostly be captured in other markets, where employment laws are less strict. This could improve visibility on delivery in our view.

Exhibit 6: Targeted synergies in M&A deals within the broader water and waste sector – as % of EBITDA acquired

Comparable M&A deals guided for synergies at around 20-25% of acquired EBITDA



Source: company filings, BofA Global Research

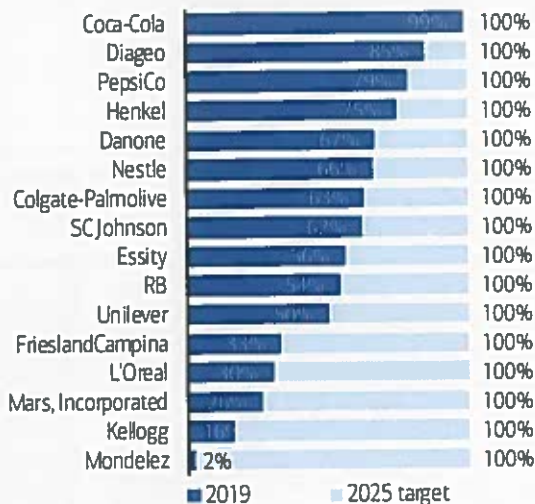
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3. Consumer preferences and the growing relevance of ESG criteria on corporate strategy are also drivers of organic growth in higher-value solutions. We highlight plastic recycling and hazardous waste treatment as two growth areas targeted by Veolia and offering high margins (c15-20%). Margin accretion could potentially be accelerated via disposals of low margin activities (collection-only contracts and facility mgmt. assets have been identified as candidates by Veolia).



Exhibit 7: Packaging design: % by weight of plastic packaging reusable, recyclable or compostable

Brands are proactively changing their plastic usage in products to reduce their waste and promote reusability



Source: Ellen MacArthur Foundation - The Global Commitment 2020 Progress Report
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Exhibit 8: Recycled content: % by weight of post-consumer recycled content in plastic packaging

Brands are embracing higher adoption of recycled plastic in their products



Source: Ellen MacArthur Foundation - The Global Commitment 2020 Progress Report
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Our bullish views on waste revenue and margins growth puts us ahead of cons.

We are c1% ahead of consensus on revenue for 2022/23, and 2-4% ahead on EBITDA, driven largely by (1) France and Rest of Europe where we forecast mid-single digit revenue growth in waste, and (2) hazardous waste, where we expect double digit revenue growth. Our EBITDA margin assumption is a tad higher than consensus – 17% vs BofA’s 17.5%.

As a result, we are c10-15% ahead on current net income (including dilution from the planned equity raise).

Exhibit 9: BofA vs Consensus

We are c10-15% ahead on net income in 2022/23

	2021E	2022E	2023E
BofA Revenue	28,482	40,311	41,851
Cons Revenue	27,575	40,013	41,341
Difference BofA to Cons	+3.3%	+0.7%	+1.2%
BofA EBITDA	4,135	6,843	7,456
Cons EBITDA	4,092	6,723	7,204
Difference BofA to Cons	+1.0%	+1.8%	+3.5%
BofA Net Income	783	1,303	1,651
Cons Net Income	779	1,179	1,437
Difference BofA to Cons	+0.5%	+10.5%	+14.9%

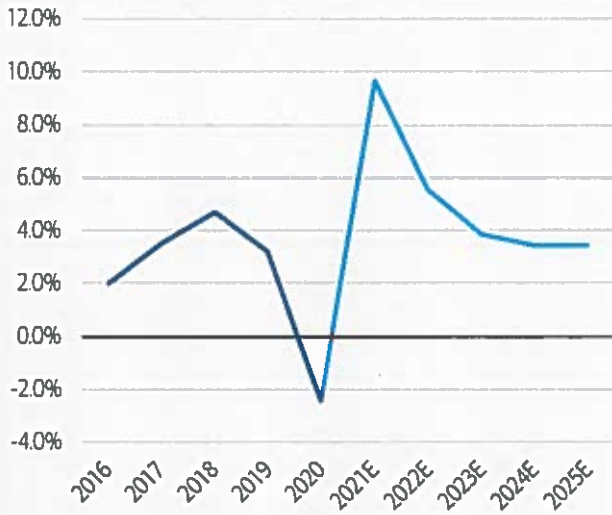
Source: company compiled consensus, BofA Global Research estimates

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Exhibit 10: Revenue delta % at constant scope and FX

We expect revenue growth to peak in 2021 from a low 2020 base, but to be sustained -4-5% beyond

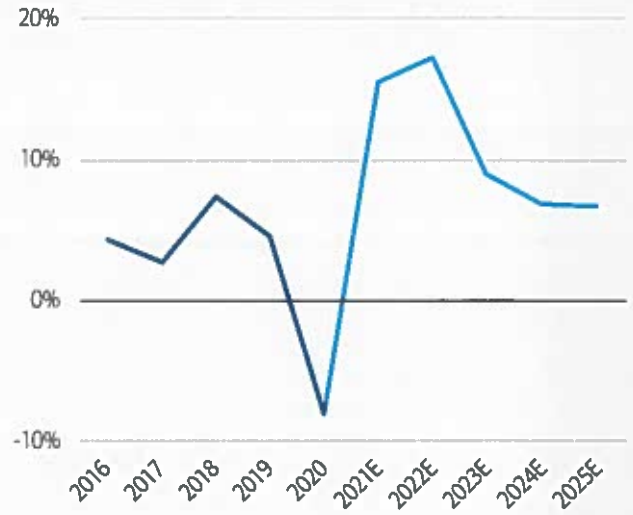


Source: company reports, BofA Global Research estimates

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Exhibit 11: EBITDA delta % at constant FX

EBITDA growth should continue in strong positive territory as Veolia delivers cost cutting and synergies on top of expected revenue growth

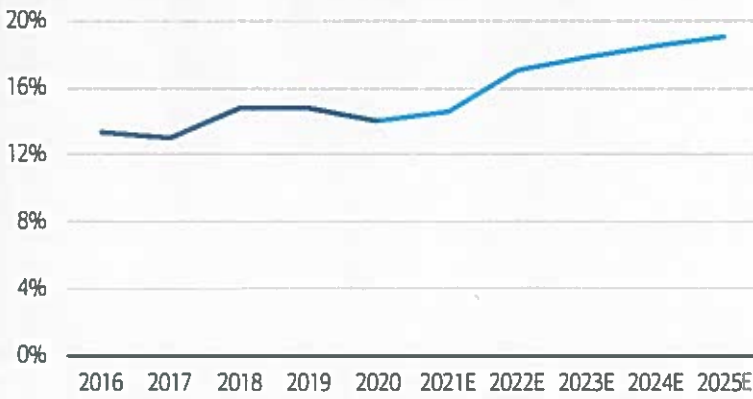


Source: company reports, BofA Global Research estimates

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Exhibit 12: EBITDA margin %

We forecast margin expansion towards the high-teens %, from mid-teens historically



Source: company reports, BofA Global Research estimates

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Recovery could continue even as macro cycle slows down

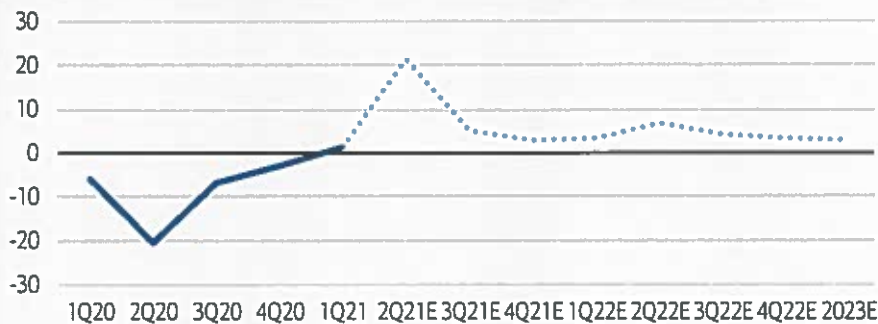
Our economists think that delta risks still cloud the Euro area outlook into 2H21, despite a stronger than expected 2Q21. In their view, the bulk of the reopening (and hence "peak" MoM growth) is behind us and macro data is likely to be mixed going forward.

Meanwhile, our equity strategists opine that the latest wave of the pandemic could drag down macro momentum, and expect fading growth and global PMIs into 2022.

In our view, that macro scenario still leaves room for a resilient waste recovery and supportive water pricing over the next 12-18 months. Our economists expect Euro area industrial production to grow at an annual pace of 3-4.5% over 2H21-2023. This indicator has historically been consistent with mid- and upper-single-digit organic growth rates in waste revenue, and we capture such scenario in our estimates.

Exhibit 13: Euro area industrial production reported and BofA forecasts (YoY %)

We expect Euro area industrial production to remain in low to mid-single digit positive territory

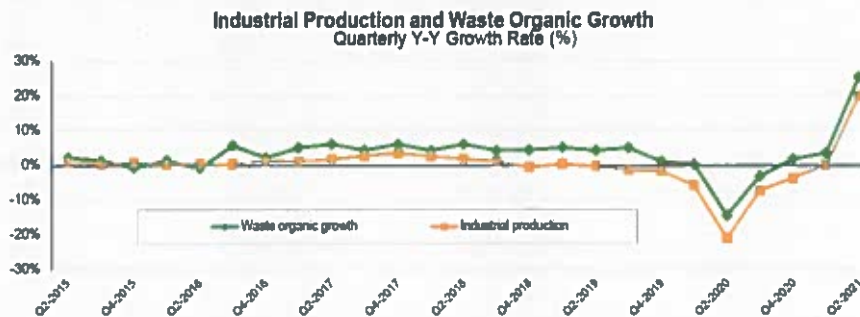


Source: Bloomberg, BofA Global Research estimates

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Exhibit 14: Weighted average industrial production indices for France, U.K, Germany, and North America; and organic revenue growth in Veolia's waste activities (quarterly YoY %)

Growth in industrial production has historically been correlated to revenue growth in waste activities



Source: Veolia's 1H21 presentation, OECD data until May 2021

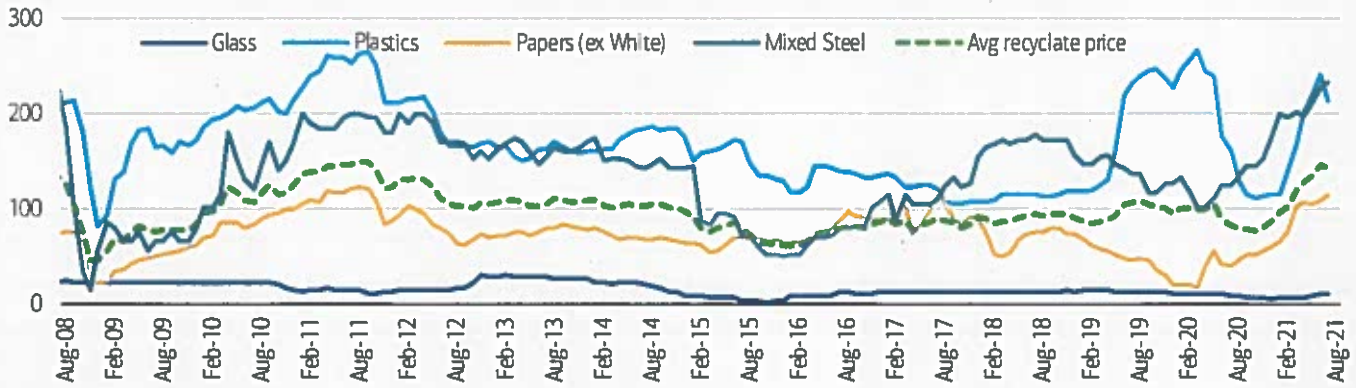
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Another datapoint supporting waste revenue growth during 2H21-1H21 are price increases across most recyclates, amidst a global rally in commodity prices.



Exhibit 15: Average recyclate prices, £/tonne

Recyclate prices are up ~50% on average from pandemic lows as recovering economic activity brings back demand for materials



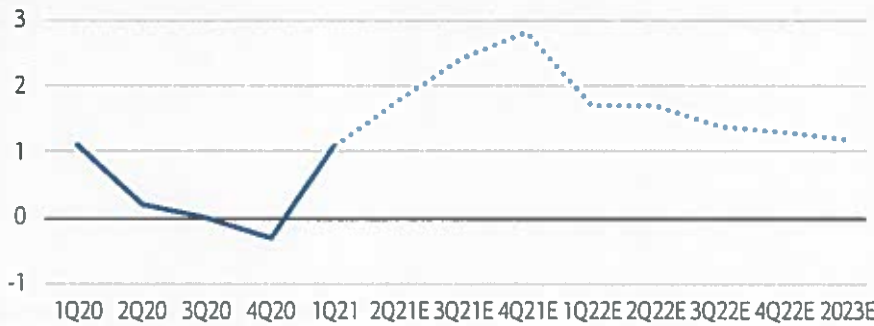
Source: letsrecycle.com, BofA Global Research

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Furthermore, our colleagues also expect higher CPI in 2H21 of c2.5%, before returning to pre-pandemic levels of 1-1.5%. This recovery in inflation from pandemic lows could be a positive for Water profitability. Historically, margins for European water contracts have been under pressure as inflation-linked revenues stayed broadly flat (no inflation and stable volumes) while wages and other costs increased. Expectations of higher CPI should drive revenue growth via price increases (normally with a time lag due to contract review) and therefore alleviate some of the previous pressure in margins. We reflect this in our assumption of low-single digit organic growth in water during 2022.

Exhibit 16: Euro area CPI (harmonised) reported and BofA forecasts (YoY %)

Peak inflation in 2H21 could ease some of the margin pressure in water contracts of Veolia over the next 6-18 months



Source: Bloomberg, BofA Global Research estimates

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35% TSR at an undemanding multiple

We value Veolia using a SOTP methodology, mainly based on a discounted cash flow (DCF) analysis for the core activities. We assume WACC ranging -6-10% for the different segments and 6-7x TV/ 2026E EBITDA multiples (net of renewal costs in France). We also include its associates and minorities at 17x P/E based on 1H21 earnings; and financial assets, debt and non-financial liabilities at book value. Our share count is pro-forma for the expected rights issue.

Exhibit 17: Our SOTP breakdown (€m)

We see c30% upside for Veolia shares

Sum-of-the-parts	Assumption	Value €m Dec'22	€ per share
France	DCF at 5.8% WACC, 6.5x TV/EBITDA multiple	6,081	9.0
Europe excluding France	DCF at 6% WACC, 7x TV/EBITDA multiple	23,480	34.8
Rest of the world	DCF at 9.7% WACC, 6x TV/EBITDA multiple	13,049	19.3
Global businesses	DCF at 7.2% WACC, 6.25x TV/EBITDA multiple	8,762	13.0
Core Enterprise Value	Equal to 7.5x EV/EBITDA 2022E multiple	51,373	76.0
+ Associates at book value	17x P/E on annualised 1H21 earnings	1,306	1.9
+ Current financial assets	Book value Dec'22	1,073	1.6
Gross asset value		53,752	79.6
- Net financial debt including liabilities from Suez and new debt	Book value Dec'22	(20,529)	(30.4)
- Hybrids	Book value Dec'22	(2,000)	(3.0)
- Provisions	Book value Dec'22	(2,358)	(3.5)
- Unlisted minorities	17x P/E on annualised 1H21 earnings	(3,247)	(4.8)
Equity value		25,618	
Number of shares (mill)		676	
Equity value per share		37.91	
Price Objective		38.00	
Current share price (€/sh)		28.63	
Upside / (downside)		33%	

Source: BofA Global Research estimates

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Despite their smaller scale, similar '22-'23 EBITDA growth rates and margins, Veolia's peers in the environmental sector trade at a higher EV/EBITDA multiple of c9x 2022E on average vs its 7.5x, or 8x incl. renewal costs reported below EBITDA.

In our view, our 7.5x EV/EBITDA 2022E multiple is undemanding. We believe Veolia benefits from a larger footprint and more comprehensive offering across waste and water versus peers, particularly after the acquisition of Suez assets.

Exhibit 18: Waste peers' trading multiples

Despite a smaller scale and similar EBITDA margins, Veolia's peers in the waste sector trade at a greater EV/EBITDA multiple - c9x 2022E vs Veolia's 7x

Competitor	Mkt cap	EV/EBITDA			EBITDA margin
		2021E	2022E	2023E	
Clean Harbors	\$5.5bn	11.4x	10.5x	9.8x	c15-17%
Biffa	£1.1bn	11.9x	9.0x	7.9x	c13-15%
FCC	€4.5bn	7.4x	6.9x	6.5x	c16-17%
Average		10.2x	8.8x	8.1x	Veolia - 15%

Source: Company filings, Bloomberg data

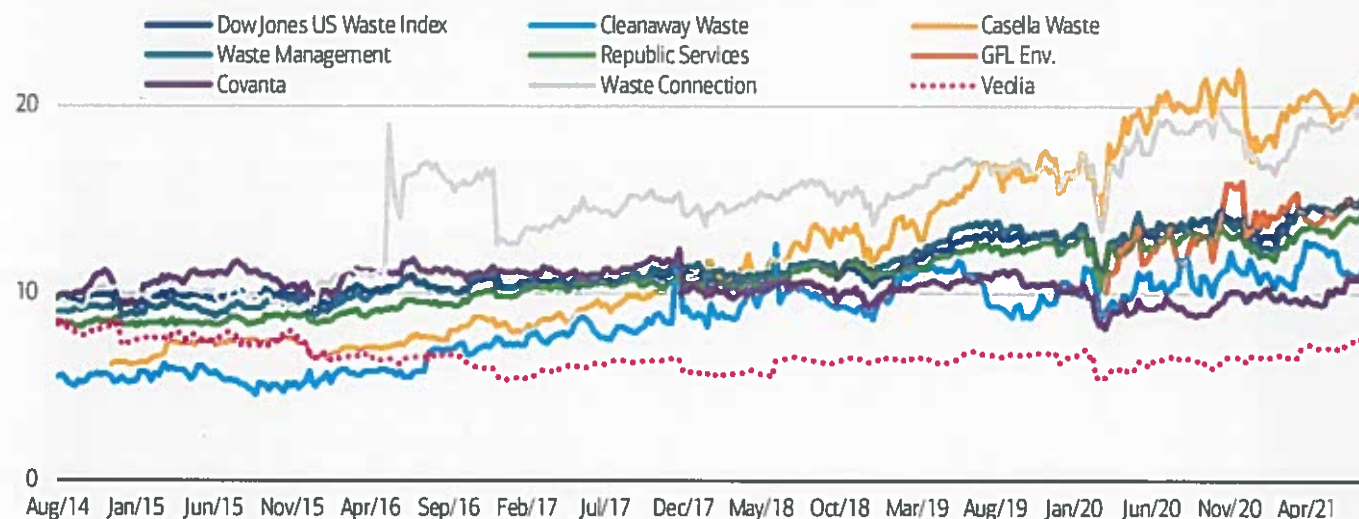
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We believe Veolia is positioned to become a key beneficiary of the EU's Circular Economy transformation (the company currently generates >60% of revenue in Europe and c35% of EBITDA from waste activities). This supportive political environment contrasts with a limited policymaker focus on recycling and waste areas in the US. Despite that, Veolia's multiple has been stagnant as metrics for US peers have expanded. We outline below several catalysts that could help reduce this gap to US peers.



Exhibit 19: EV to forward Bloomberg estimate EBITDA ratio for US waste peers

Veolia's EV/EBITDA multiple has underperformed US waste peers' despite a better policy outlook in Europe



Source: Bloomberg

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Catalysts

We see three catalysts for multiple re-rating over the next 12-18 months:

- Removal of overhang risk associated with the pre-announced €2.5bn equity raise to partially fund the Suez acquisition, which, in accordance with the transaction timeline, would likely be during 4Q21.
- Europe is still to publish most of the new regulation implementing its Circular Economy plan, due over 2021/22. We expect two key pieces, the sustainable product policy initiative and the revision of waste shipments rules, to come before year-end.
- A potential announcement for a strategy update or CMD presenting new long-term targets once Suez assets are integrated – likely in 2H22.

We include the planned rights issue in our forecasts

We assume successful closing of the deal and consolidation of Suez from January 2022 in our estimates, as well as a €2.5bn capital raise at c€26/sh (10% discount to 26/Aug closing).

Exhibit 20: Rights issue - dilution sensitivities

A potential €2.5bn rights issue by Veolia could be 15-18% dilutive at 0-15% discount to current trading price

Issuance price (€/sh)	29.00	27.55	26.10	24.65
Discount to closing price 26/Aug/21	0%	-5%	-10%	-15%
Diluted share count (mill.)	580	580	580	580
New shares (mill.)	86	91	96	101
Dilution	14.9%	15.6%	16.5%	17.5%

Source: BofA Global Research estimates, Bloomberg, N/A assumes €2.5bn gross proceeds

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EDPR

US Presidential Election scenarios: good, better, best

Reiterate Rating: BUY | PO: 19.00 EUR | Price: 16.28 EUR

A Buy irrespective of the Presidential Election outcome

Nov. 3rd is set to be a key date for EDPR, the most exposed stock in our coverage to the US renewables market. A Democratic victory may boost its growth outlook, potentially worth c30-50% upside, however we see c20% upside even in a re-election scenario. We lift our PO to €19 on stronger policy support and a better long term outlook (up from €15.5), and reiterate Buy. EDPR remains in our Europe 1 and "What's big in SMID" lists.

A Republican victory means status quo remains

Our investment case is based on a compelling growth outlook in the US, supported by renewables' cost advantage, coal/nukes closures, green energy pledges by corporates and renewable mandates by States. A Republican victory is unlikely to challenge any of those, therefore we expect the US to remain an attractive growth market for EDPR.

Biden Presidency is not enough to implement climate plan

A Democratic win presents upside risks to our investment case. A Biden executive alone may be able to implement tax credit extensions and to support transmission upgrades, favouring renewables expansion. However greater plans may face Congress' opposition.

Control over Congress key to deliver clean energy overhaul

In our view, Biden's climate plan of 100% clean energy by 2035 would likely require a Democratic sweep win to go ahead. This would unleash US\$2tn of capex in four years and possibly a -5x increase in renewable annual build-out. We think EDPR may capture some additional growth, potentially worth €5/sh. We discuss US Election scenarios and the implications on EDPR's growth outlook in page 3 of this report.

Discount to US peers continues despite recent rally

Headline valuation trails US peers despite a 50% earnings exposure to NorthAm., a cleaner mix and #3 onshore share in the US market (EDPR sub-13x EV/EBITDA '21E vs. NextEra at 17x). EDPR continues to offer an attractive mix of quality and secular growth in renewables, while benefiting from reducing financing constraints at parent-EDP.

Estimates (Dec)

(EUR)	2018A	2019A	2020E	2021E	2022E
EPS (Adjusted Diluted)	0.36	0.54	0.64	0.53	0.60
EPS Change (YoY)	14.1%	51.4%	18.3%	-16.8%	12.0%
Dividend / Share	0.07	0.08	0.09	0.10	0.11

Valuation (Dec)

	2018A	2019A	2020E	2021E	2022E
P/E	45.6x	30.1x	25.4x	30.6x	27.3x
Dividend Yield	0.43%	0.49%	0.55%	0.61%	0.68%
EV / EBITDA*	18.7x	14.7x	14.3x	14.5x	13.7x
Free Cash Flow Yield*	-0.96%	-3.87%	-10.3%	-9.74%	-9.82%

* For full definitions of "Adjusted" measures, see page 15.

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Refer to important disclosures on page 16 to 18. Analyst Certification on page 13. Price Objective Basis/Risk on page 13.

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Timestamp: 13 October 2020 12:00AM EDT

13 October 2020

Equity

Key Changes

(EUR)	Previous	Current
Price Obj.	15.50	19.00
2020E EPS	0.48	0.64
2021E EPS	0.52	0.53
2022E EPS	0.59	0.60

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Stock Data

Price	16.28 EUR
Price Objective	19.00 EUR
Date Established	13-Oct-2020
Investment Opinion	A-1.7
52-Week Range	8.43 EUR-16.50 EUR
Mkt Val / Shares Out (mn)	14,201 EUR / 872.3
Average Daily Value (mn)	5.90 USD
Free Float	17.4%
BofA Ticker / Exchange	EDPRV / LIS
Bloomberg / Reuters	EDPR PL / EDPR.LS
ROE (2020E)	7.7%
Net Dbt to Eqty (Dec2019A)	34.0%

PTC: Production Tax Credit

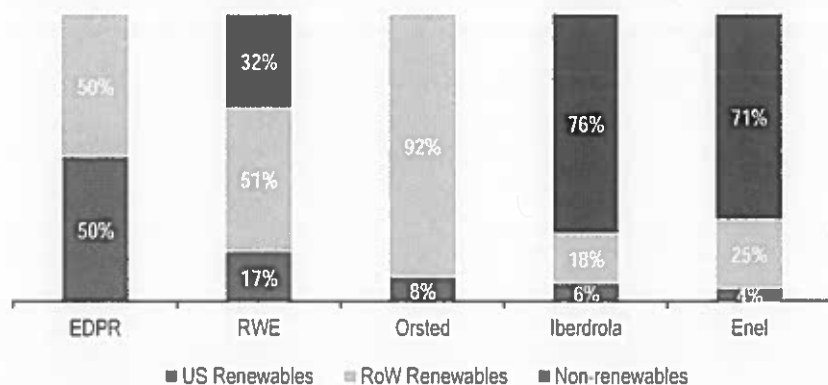
ITC: Investment Tax Credit

US Elections: big promises, big potential

The US Presidential Election has already become a key event for EDPR. The outcome of it is likely to materially shape the growth outlook for renewables in the US, judging by the vast differences in climate policies presented by each candidate. While several developers in our coverage operate in the US, EDPR stands out as the most exposed to this market, representing around 50% of earnings and 60% capex. Other Buy rated stocks with US exposure are Orsted, RWE, Enel and EDF, although all exhibit a relatively lower share of earnings from US renewables compared to EDPR (see chart below).

Chart 1: EDPR screens as the #1 exposed stock to the US renewables market with around half of EBITDA

Share of EBITDA from renewables, US and non-US



Source: BofA Global Research, company data. NB: RWE shown as share of core EBITDA, excluding nuclear and coal earnings.

Our US colleagues have examined the policy implications of several election scenarios, which we discuss below and also summarise in Table 1.

Table 1: Summary of policy plans impacting renewables deployment in the US

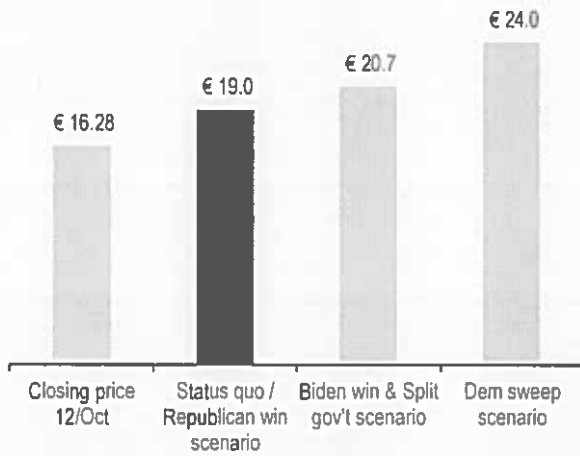
Policies	Biden, Split gov't	Dem sweep	Trump, Split gov't or Rep sweep
	Plan for 100% clean energy by 2035 to face an uphill battle in Congress	Push to implement 100% clean energy by 2035; US\$2tn investment on clean energy over four years	Clean energy goals would continue to be set at the state (RPS standards) and company levels (Corporate PPAs).
	Re-enter Paris Accord Diplomatic push to raise climate targets of other countries Federal gov't procurement drive towards clean energy / zero emissions	Potential for a carbon tax <i>(plus those under a Biden, split gov't)</i>	
Transmission	Increased support for Transmission upgrades, enabling renewables integration	Substantial transmission deployment both East to West and North-South requiring large scale investment	
ITC extension	Potential extension of solar tax credit runway out from '23 to '26-'28, may require Senate approval		
PTC extension	Potential extension but may exclude onshore wind and only focus on EVs, batteries, offshore wind, hydrogen and other emerging tech		

Source: BofA Global Research

We attempt to capture the implications of each election outcome on EDPR's valuation in our three scenarios described below. We summarise our assumptions for annual installations and our price sensitivities for each one in the two charts below.

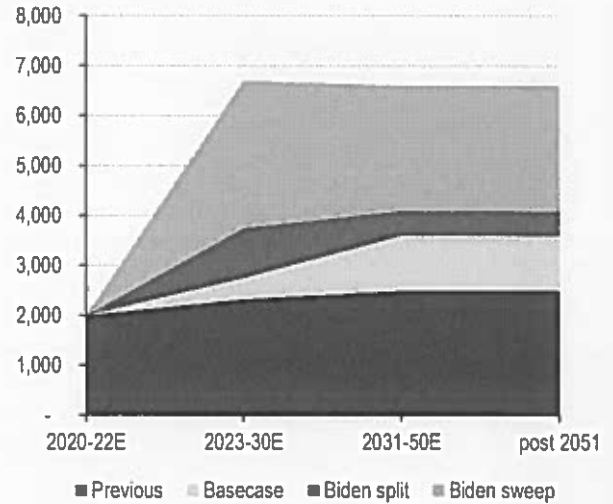


Chart 2: Valuation and sensitivities under each scenario



Source: BofA Global Research, Bloomberg. NB: upside shown based on 9/Oct closing prices. Dem. sweep scenario considers diluted share count as per our equity raise assumption.

Chart 3: Summary of gross MW built by EDPR under each scenario



Source: BofA Global Research

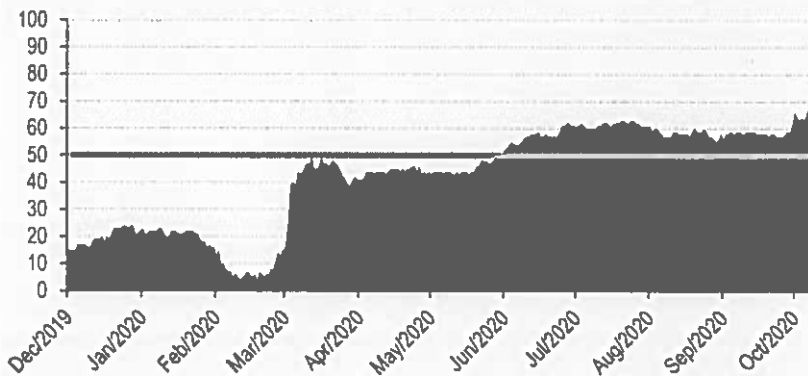
Good: Trump, split gov't or Republican sweep

- **Status quo remains:** sector headwinds like long transmission queues and tax credits phase-outs may remain unaddressed.
- **However, the growth outlook would still be appealing:** In spite of unsupportive federal policies, several factors that have favoured renewables growth in the past 4 years. We see no reason for those not to continue going forward. We believe technology cost declines (larger turbines, cheaper and more efficient PV panels), State level policies (including Renewable Portfolio Standards and coal/nuclear closures) and green energy demand from corporates would provide a reasonably supportive growth outlook. Several large corporates including Amazon, Facebook, Google and Verizon have announced their own net zero pledges in recent months. This announcements support green energy demand growth by the private sector, which represents ~50% of the market.
- **We see upside even under a Republican win.** Our new €19 PO does not reflect any changes to US policies or tax credit extensions, given those are unlikely in a re-election scenario. Nevertheless, we still see upside based on a stronger EU policy support for renewables and a greater opportunity long term (discussed in the next section of this report).
- Given that some chances of a potential Democrat victory are priced in, we think investors should be prepared for a potential sell off if a Republican win unfolds. However, this would have no impact on our investment thesis.



Chart 4: Probability of Biden winning the US Presidential Elections

Implied probability based on quotes available on the Predictit website.



Source: Bloomberg (PRTUS2D Index), BofA Global Research

Better: Biden, split gov't

- **Improved near and mid-term outlook:** here we consider potential tax credit extensions to be more likely. Those would provide an immediate boost to the wind sector given that subsidies (Production Tax Credits or PTCs) are due to be phased-out after 2020. Furthermore, increased support for transmission upgrades may address a common development bottleneck and make previously shelved projects economical again.
 - A wind tax credit extension has already been proposed: the Growing Renewable Energy and Efficiency Now (Green) Act, introduced by two Democrat representatives, includes plans to extend PTCs at 60% of its original value to 2025.

Table 2: Current PTC phase-out schedule

Year construction started	Last year to start operations	PTC Rate*
2016	2021	100% of relevant PTC rate
2017	2022	80% of relevant PTC rate
2018	2022	60% of relevant PTC rate
2019	2023	40% of relevant PTC rate
2020	2024	60% of relevant PTC rate

Source: BofA Global Research. *PTC full value c.\$25/MWh (2019), Inflation linked.

- **A greater opportunity to capture:** we think a combination of transmission upgrades, faster coal and nuclear closures, and renewable subsidies extension could accelerate the pace of solar and wind installations in the US. We quantify the impact for EDPR as an extra 1GW installed p.a. over 2023-30 vs. our basecase. Also we include an additional 500MW p.a. post-2030 as the impact of those policies translates into a long lasting benefit for the industry.
 - This scenario would present further upside, adding an extra 1.7€/sh to our valuation.

Best: Democratic sweep

- **Blue sky scenario could kick-start a transformational change:** with control over the Congress, Democrats would be able to introduce a 100% clean energy target by 2035 and to unlock US\$2tn in clean energy investments over four years.
- In our view, delivering on the 2035 target would imply:



- >100GW of new solar and wind, a ~5x increase in annual deployment compared to 2019 levels (c.22GW)
- We estimate total power sector capex, including storage and transmission, of around US\$300bn p.a. This is ~2.5x the US\$120-130bn p.a. expected for the sector in 2020-21 (Edison Electric Institute data)
- Some of the capex and capacity estimates implied by the 2035 target may seem difficult to achieve given the recent installation pace. Even if the sector is not able to deliver those volumes in full, we still think that the change in policies would unlock a vast opportunity for developers.

Table 3: Quick maths behind Biden's 2035 ambition of 100% clean energy

	2019			2035E - 100% Renewables			Comments
	GW	TWh	LF %	GW	TWh	LF %	
Natural gas	473	1,558	38%				
Coal	231	943	47%				
Hydro	99	287	33%	99	287	33%	
Renewables	154	410	30%	1,278	3,403	30%	Assumes technology enables full phase-out of fossil fuels
Nuclear	99	820	95%	50	410		Assume replacements and closures lead to 50% capacity reduction
Petroleum and others	44	82	21%				
Total	1,100	4,100			4,100		Assumes no change to power demand

Change in renewable capacity 2019-35E	1,124 GW	Does not account for replacements and repowering
Average annual installations if build over 2024-35E	102 GW	
Solar and wind installations in 2019	22 GW	c9GW onshore, c13GW solar PV
Required increase in annual installations	4.6x	

Source: US Energy Information Administration (eia.gov), BofA Global Research estimates.

- While we see several practical hurdles for the sector to deliver those installation volumes, we assume those are overcome for modelling purposes.
 - We note that supply chain constrains, permitting, land availability and financing could be limiting factors. However we assume those are addressed during the 4-year term, leaving an 11-year window to deliver the complete generation mix transformation.
- We assess the implications of this scenario on EDPR's future growth prospects on the basis of the following assumptions:
 - EDPR loses some market share to new entrants, although it is able to maintain a leading position. The company is able to install c6.7GW p.a. over 2024-35E, a ~3.4x / 4GW increase in US volumes compared to our basecase (vs. a 4.6x increase in the US addressable market).
 - EDPR is able to finance growth while sustaining a Net Debt/EBITDA ratio below 3.5x (in line with renewable peers Orsted and RWE), owing to a combination of:
 - A €2.5bn capital increase, which we model in 2024, equivalent to a 20% of the issued capital and priced at €15/sh. Recent equity increases by EDP and RWE have proven in our view that the market is open to fund growth in renewables.
 - Ongoing capital rotation of c50% of capacity, by means of build-to-sell projects for state utilities, farm-downs to financial investors, or other similar mechanisms. We note that



Biden's plan acknowledges the issue of attracting sufficient private investment, for which it contemplates "innovative financing mechanisms" yet to be defined.

- **Ambitious plan presents large upside potential:** assuming all potential hurdles are effectively addressed, this scenario would present €5/sh upside (~50%) to our basecase (on a diluted share basis).