Dong Energy

Sale on track

This is a complex product

We commence coverage of DONG's new €4.875% 3018 issue with a BUY recommendation

Dong will issue an additional hybrid bond with a coupon of 4.875% and a minimum trading lot of EUR 1,000. The bond will be issued with a spread to the EUR 5Y swap rate of 380 bps, which is in line with the two existing hybrid issues when adjusted for the maturity. We therefore commence coverage of the new issue with a BUY recommendation.

The new bond

The new bond is a hybrid with a formal maturity of 1000 (one thousand) years. The equity content will be 50% until first "call date" in 2018, and the issue will receive a BB+ rating with S&P, Baa3 with Moody's and BBB- with Fitch. As the bond will lose its equity content with S&P in 2018, is it most likely that DONG at that point will redeem at 100. First step-up of 25 bps is in 2023. There is another step-up of 75 bps in 2038. The yield will be fixed every five years, based on the EUR5Y swap rate plus 380 bps. The new bond has a "rating event" covenant that may be activated if the rating agencies change the equity content. As the rating agencies have just confirmed an equity content of 50%, we do not expect this to materialise. If, contrary to expectations, it does materialise, this will obviously be negative for the price.

DONG is still an attractive exposure

We are confident that the scheduled capital increase will be implemented before the end of 2013, so the current BBB+ company rating can be maintained. DONG has already proceeded far in the planned sale of assets in the amount of DKK 10bn, and its profitability continues to strengthen. The cash flow over the next years will improve as three major off-shore wind farms (London Array, Anholt and Lincs) are put into operation and the production from Syd Arne 3 begins.

Issue	Rec.	Risk	Price	Yield	Bid Spread	Bid Spread Target	Bid Price target	Exp. 12M Return	Rating*
€5,5% 3005	BUY	Low	105,50	2,6%	321	200	103	3,0%	BBB-
€6,25% 3013	BUY	Medium	102,75	5,9%	433	425	102	5,5%	BB+
€4,875% 3013	BUY	Medium	99,50	5,0%	441	395	100,75	6,2%	NR

Note: When on strong buy, buy or hold the offer price/yield is shown. When on sell the bid price/yield is shown.
**Composite rating. Source: Bloomberg

Recommendations:

BUY: €5.5% 3005 - XS0223249003
BUY: €6.25% 3013 - XS0560190901
BUY: €4.875% 3013 - XS0943371194

DKK mio.	2011R	2012R	2013E
Rev.	56.842	67.243	70.605
EBITDA	13.780	8.632	13.415
Adj. Leverage	2,2	4,6	2,5

€5.5% 3005

Source: Jyske Bank & Bloomberg

Jyske Markets
Vestergade 8-16
DK - 8600 Silkeborg

Analyst:
Jens Houe Thomsen
Senior Corporate Bond Analyst
+45 89 89 76 88
jht@jyskebank.dk

Translation:
Translation Services

This investment research report is for professional investors only.

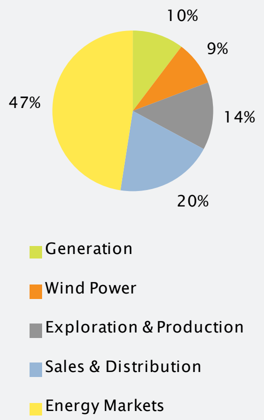
Disclaimer:
Please see the last pages.

Overview

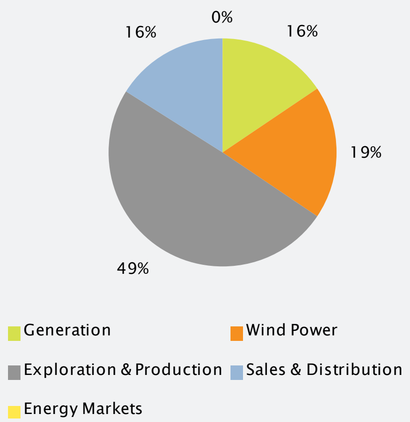
Company profile

DONG Energy A/S is an integrated energy group which procures, produces, distributes and trades energy and associated products in Northern Europe. The company is a market leader in the Danish energy market where DONG accounts for 54% and 35% of the Danish power and heat production, respectively. Growth is still expected to come from continued expansion in other Northern European energy markets.
The Danish state is still a major shareholder (80%) and an IPO does not appear to be on the programme until after 2015.
The company has clear ambitions to be a leader within clean and reliable energy. The target is to reduce CO2 emission to 15% of the current level over the next 30 years through a transformation of the production into renewable energy.

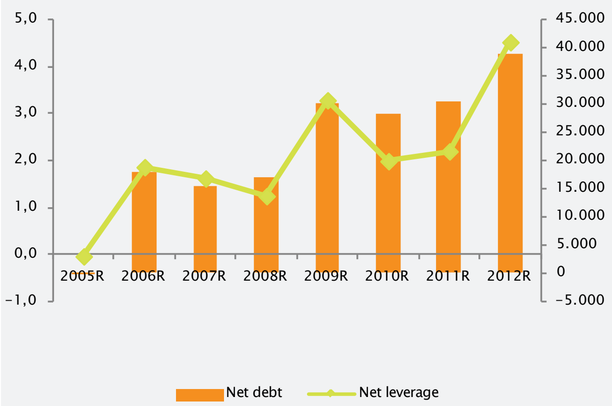
Revenue by segment



Earnings by segment (EBITDA)



Net debt and net leverage



Fundamental valuation

- S&P has a BBB+ rating for Dong Energy with a negative outlook, while Moody's rating is Baa1.
- This rating reflects the company's strong position in Denmark and the support from the Danish state.
- The company aims to maintain its BBB+/Baa1 credit rating as a minimum.

Investment case

- Turnaround of the company is expected to restore profitability and improve the return in the coming years.
- The flagging profitability within gas and the focus on growth have increased net debt somewhat over the past year.
- A capital increase, sale of non-core activities as well as improved profitability are to reduce the leverage to the level below 2.5x in 2014.

Price triggers

- Upgrade of the credit rating by the international credit-rating agencies.
- Very cold and long winter with high energy consumption and resultant high power prices.
- New finds, for instance in the North Sea.
- New large orders within the wind area.
- Increased monetarisation of the company's knowledge within green energy.

Risk factors

- Large investment programme, particularly within offshore wind energy, involves technological, operational and regulatory risks.
- A high share of production from mature fields in the North Sea.
- Investment programme may not deliver the expected return.
- Fluctuating energy prices and particularly the development in the spread between the oil and gas price.
- Diversification to other geographical markets than Denmark reduces the risk but also exposes the company to other regulatory regimes, although they are all EU countries.

Income statement (DKK mio.)	2010R	2011R	2012R	2013E	2014E
Revenue	54.616	56.842	67.243	70.605	74.136
EBITDA	14.135	13.780	8.632	13.415	14.456
EBIT	8.120	6.110	-3.481	4.942	5.560
Net finance costs	1.595	282	1.353	1.991	1.939
Net income	4.499	2.892	-4.021	4.376	5.369

Balance Sheet (DKK mio.)	2010R	2011R	2012R	2013E	2014E
Short term debt	4.699	5.512	5.632	5.632	5.632
Long term debt	35.194	37.044	51.900	51.054	50.827
Total debt	39.893	42.556	57.532	56.686	56.459
Liquidity	11.767	12.256	18.500	23.007	23.680
Net debt	28.126	30.300	39.032	33.679	32.779
Tangible assets	80.685	94.510	96.307	97.834	98.938
Intangible assets	2.751	2.729	2.425	2.425	2.425
Equity	47.793	49.788	42.959	52.978	57.015
Share of equity	34,8%	32,3%	26,9%	34,5%	36,5%
Total assets	137.339	154.073	159.594	153.409	156.192

Cash Flow (DKK mio.)	2010R	2011R	2012R	2013E	2014E
Funds From Operations (FFO)	**13.771**	**12.367**	**12.327**	**14.656**	**15.906**
Cash flow from operations (CFO)	**14.260**	**10.809**	**9.174**	**14.966**	**16.814**
CAPEX	14.793	19.338	20.004	10.000	10.000
Free cash flow before interests expenses (FCF)	**-533**	**-8.529**	**-10.830**	**4.966**	**6.814**
Net finance costs	-1.122	-4.918	-13.026	2.489	2.424
Free cash flow after net finance costs	**589**	**-3.611**	**2.196**	**2.477**	**4.390**
Redemption/amortization of debt	0	0	0	2.123	4.312

Credit metrics	2010R	2011R	2012R	2013E	2014E
EBITDA margin	25,9%	24,2%	12,8%	19,0%	19,5%
Adjusted EBITDA margin	26,0%	24,3%	12,9%	19,1%	19,6%
EBIT margin	14,9%	10,7%	-5,2%	7,0%	7,5%
Adjusted EBIT margin	14,9%	10,8%	-5,1%	7,0%	7,5%
EBITDA/Financial expenses	7,6	10,8	4,8	5,4	6,0
Adjusted EBITDA/Financial expenses	7,6	10,8	4,8	5,4	6,0
CFO/Financial expenses	7,6	8,5	5,1	6,0	6,9
Adjusted CFO/Financial expenses	7,7	8,5	5,1	6,0	7,0
FCF/Financial expenses	-0,3	-6,7	-6,0	2,0	2,8
Total debt/EBITDA	2,8	3,1	6,7	4,2	3,9
Net debt/EBITDA	2,0	2,2	4,5	2,5	2,3
Adjusted net debt/EBITDA	2,0	2,2	4,6	2,5	2,3
CFO/Total debt	35,7%	25,4%	15,9%	26,4%	29,8%
Adjusted CFO/Total debt	35,9%	25,5%	16,0%	26,5%	29,8%
FCF/Total debt	-1,3%	-20,0%	-18,8%	8,8%	12,1%
Net debt/Equity	0,6	0,6	0,9	0,6	0,6
CFO/Revenue	26,1%	19,0%	13,6%	21,2%	22,7%
FCF/Revenue	-1,0%	-15,0%	-16,1%	7,0%	9,2%
Capex/Revenue	27,1%	34,0%	29,7%	14,2%	13,5%

Quarterly expectations	Q2-12R	Q2-13E	Change (%)
Revenue	15.377	14.026	-8,8%
EBITDA	4.690	2.890	-38,4%
Net debt	42.685	34.230	-19,8%
EBITDA margin	30,5%	20,6%	-990 bp.
Net leverage	3,2x	4,3x	1,1x

Source: Jyske Bank & Dong Energy A/S.

Disclaimer & Disclosure

Jyske Bank is supervised by the Danish Financial Supervisory Authority.

The research report is based on information which Jyske Bank finds reliable, but Jyske Bank does not assume any responsibility for the correctness of the material nor any liability for transactions made on the basis of the information or the estimates of the report. The estimates and recommendations of the research report may be changed without notice. The report is for the personal use of Jyske Bank's customers and may not be copied.

This report is an investment research report.

Conflicts of interest

Jyske Bank has prepared procedures to prevent and preclude conflicts of interest thus ensuring that research reports are being prepared in an objective manner. These procedures have been incorporated in the business procedures covering the research activities of Jyske Markets, a business unit of Jyske Bank.

Jyske Bank's corporate-bond analysts may not hold positions in the instruments for which they prepare research reports. If an analyst takes over for the responsible analyst in connection with illness, business travels, etc. this analyst cannot trade in the relevant corporate bond on the day of publication of the research report and the following day. Jyske Bank may, however, hold positions, have interests in or business relations with the companies that are analysed. The research report has not been presented to the company prior to its release. Analysts receive no payment from persons interested in individual research reports.

Read more about Jyske bank's policy on conflicts of interest at www.jyskebank.dk/terms.

Jyske Bank’s corporate bond recommendations - current breakdown

Breakdown of recommendations, corporate bonds (number)

Source: Jyske Bank

Financial models

Jyske Bank models the expected development of the analysed company's income statement and balance sheet. A number of key figures for the company is calculated on the basis of these models, and the key figures are compared with those of comparable companies and the company's past performance. From this we infer the spread at which the bonds will trade for the period ahead. The recommendation and the price target are moreover adjusted for the expected news flow and the market sentiment based on knowledge of the industry and company-specific circumstances. Jyske Bank's recommendations take into account the expected development in the corporate-bond market, the various sectors and company-specific circumstances.

Risk

Investment in this corporate bond is associated with risk. The risk can be measured directly via the spread at which the bond trades relative to a 'risk free' investment with the same maturity. The spread reflects the probability of default, the recovery rate, and the liquidity of the corporate bond. Movements in the credit market, the sector and/or news flows, etc. regarding the company may affect the price of the bond. See the front page of the research report for our view of the risk associated with the corporate bond. The risk on the corporate bond is stated as Very Low, Low, Medium, High or Very High and is relative to the high-yield market for corporate bonds. The risk factors stated and/or calculations of sensitivities in the research report are not to be considered all-encompassing.

If the corporate bond is denominated in a currency other than the investor's base currency, the investor accepts an FX risk.

Update of the research report

The planned update of the report will be prepared immediately upon the release of the company's financial statements. In addition, there may be prepared research reports on special themes specifically for the company or research reports where the company is part of the special theme. These research reports are published on an ad-hoc basis.

See the front page for the initial date of publication of the report.

The prices stated are the latest prices quoted by Jyske Bank before the publication of the research report, unless otherwise stated.

Recommendation concepts

Our recommendations are based on market developments and an assessment of the expected return within the next twelve months. A BUY recommendation or a Strong BUY recommendation is based on expectations that investment in the bond will generate a return above that of the general corporate-bond market. On the other hand, a SELL recommendation implies that we expect investment in the bond to generate a return below that of the general corporate-bond market.

Since our recommendations are relative and risk-adjusted, it is possible to compare our recommendations across sectors and risk categories. In addition, the potential is stated in absolute terms via our return target.

The future and historical returns estimated in the research report are stated as returns before costs and tax-related circumstances since returns after costs and tax-related circumstances depend on a number of factors relating to individual customer relations, custodian charges, volume of trade as well as market-, currency- and product-specific factors. It is not certain that the bond will yield the stated expected future return/s. The stated expected future returns exclusively express our best assessment.

Investment Centre North
Toldbod Plads 1
DK – 9000 Aalborg

Investment Centre MidWest
St. Torv 1
DK – 7500 Holstebro

Investment Centre SouthWest
Torvet 21
DK – 6700 Esbjerg

Investment Centre East Jutland
Østergade 4
DK – 8000 Århus C

Investment Centre Triangle Region
Hjulmagervej 8 F
DK – 7100 Vejle

Investment Centre Copenhagen
Vesterbrogade 9
DK – 1780 Copenhagen V

Investment Centre Zealand
Nørregade 6
DK – 4100 Ringsted

Investment Centre Funen
Mageløs 8
DK – 5100 Odense C

Investment Centre Silkeborg
Vestergade 8-10
DK – 8600 Silkeborg

Jyske Bank (Schweiz) AG
Tel.: +41 44 368 7373

Berben's Effectenkantoor B.V.
Tel: +31 (0)495 456000

PBC Hamburg
Tel.: +49 40 309 510 24

Jyske Bank (France)
Tel.: +33 493 39 39 00

Jyske Bank (Gibraltar) Ltd
Tel.: +350 20072782

Private Banking Copenhagen (PBC)
Tel.: +45 89 89 62 32