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TRABAJO FIN DE MÁSTER

**Analysis of the Iberdrola – PNM Resources Deal  
and its Financial and Strategic Impact**

Autor: Manuel Alejandro Asís Berarducci

Director: Luis García Jiménez

Madrid



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Madrid





## Análisis de la transacción Iberdrola – PNM y su impacto financiero y estratégico

Autor: Asís Berarducci, Manuel Alejandro

Director: García Jiménez, Luis

### RESUMEN DEL PROYECTO

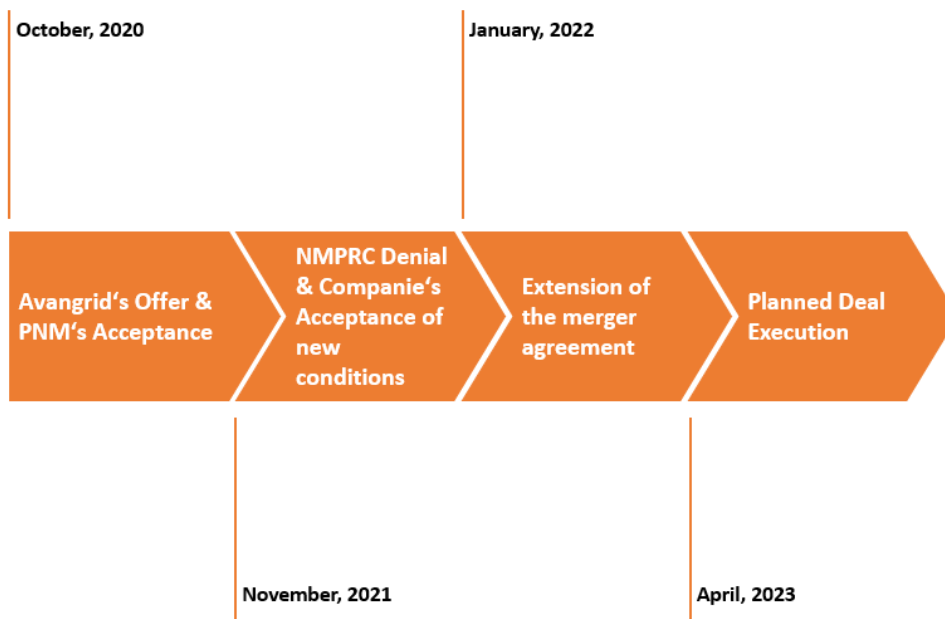
En octubre de 2020, Avangrid (NYSE:AGR), la filial norteamericana de Iberdrola (BME:IBE), hizo una oferta para la adquisición de la empresa PNM Resources (NYSE:PNM), con sede en Nuevo México, en una operación totalmente en efectivo con una valoración de 8.300 millones de dólares de Enterprise Value y 4.320 millones de dólares de Equity Value. Los accionistas de la empresa objetivo aceptaron la propuesta basada en obtener 50,3 USD en efectivo por cada acción ordinaria que poseyeran.



A fecha de hoy, hasta cinco agencias federales y la Comisión de Servicios Públicos de Texas han dado luz verde a la propuesta de Avangrid. Sin embargo, la Comisión de Regulación Pública de Nuevo México (NMPRC, por sus siglas en inglés), que era la última autoridad en el proceso de autorización, rechazó el acuerdo, votando a favor, tras una recomendación del examinador de la audiencia de la PRC, de que los riesgos potenciales para los consumidores superan los beneficios de la propuesta. El examinador añadió su preocupación por los posibles conflictos de intereses en la estructura corporativa de la empresa fusionada, los problemas éticos y el "pobre" historial de los servicios públicos de Avangrid en el noreste de EE.UU., donde la empresa opera principalmente.

El cierre de esta transacción sigue, por lo tanto, sin resolverse. Los comisarios no celebraron una votación formal sobre la transacción, y los reguladores han indicado que podrían estar abiertos a reabrir el caso para considerar nuevas modificaciones del acuerdo por parte de las empresas. Avangrid y PNM anunciaron en **noviembre de 2021** que aceptarían las condiciones adicionales señaladas por el examinador, incluidos los compromisos de gobierno corporativo y la protección financiera adicional para los clientes.

El **3 de enero de 2022**, PNM Resources y AVANGRID anunciaron una modificación y ampliación de su acuerdo de fusión hasta el **20 de abril de 2023**, así como una apelación de la decisión de la NMPRC ante el Tribunal Supremo de Nuevo México. No existe un plazo legal para que el Tribunal actúe.



## ALCANCE DEL TRABAJO Y RESULTADOS

El perímetro de este proyecto ha sido el análisis exclusivamente estratégico y financiero de la transacción, basado en valoraciones de PNM (el target), obtenidas usando distintos métodos y obteniendo una estimación final a partir de los distintos resultados obtenidos. A partir de los mismos, se puede comparar lo dispuesto en la oferta con el valor de mercado y el valor intrínseco calculado.

Cabe destacar que, al tratarse de valoraciones basadas en proyecciones, a su vez sujetas a hipótesis producto del criterio del autor del proyecto, los resultados de la valoración intrínseca son subjetivos.

El proyecto contiene una primera dividida en dos secciones: (i) una primera introductoria sobre la situación de la transacción, el estatus del comprador y la justificación estratégica del movimiento, y (ii) una segunda sección didáctica sobre los principios teóricos de los métodos de valoración usados, de las distintas transacciones de M&A y sus motivaciones. Posteriormente, se procede a la ejecución de las valoraciones y el análisis de resultados.

Esta primera parte consta de las siguientes secciones:

- Análisis de la situación actual y estratégico del comprador (matriz y subsidiaria ejecutora).
- Métodos de valoración intrínseca y relativa a implementar en el proyecto (Descuento de Flujos de Caja por (i) Múltiplo de Salida y (ii) por Crecimiento Perpetuo, y Compañías Comparables).
- Análisis de las diferentes razones estratégicas por las que se llevan a cabo este tipo de transacciones, e identificación del tipo de adquisición en cuestión: **transacción horizontal**, es decir, implica a dos empresas que operan en el mismo tipo de negocio.

La competencia entre empresas que operan en el mismo sector suele ser elevada, por lo que este tipo de operaciones suelen generar:

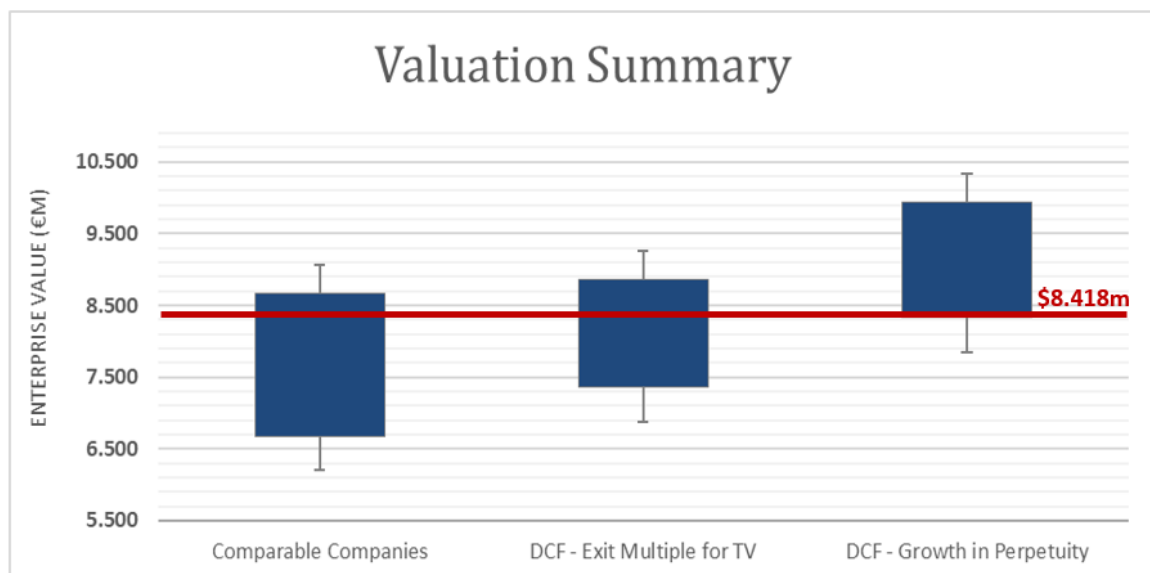
- (i) Importantes sinergias operativas y posibles ganancias de cuota de mercado (aumento del poder de mercado). Son una forma de eliminar la competencia al crear una empresa poderosa en lugar de dos competidoras, y su punto principal es la generación de sinergias operativas, es decir, las fusiones horizontales pueden aumentar mucho los ingresos, ya que las empresas combinadas tienen acceso a una mayor variedad de productos o servicios.
- (ii) Sinergias de costes por combinación de activos y economías de escala.

Este es el caso de la operación Iberdrola-PNM Resources. Iberdrola pretende integrar en su filial estadounidense Avangrid a uno de sus competidores en el país (PNM Resources opera en el suroeste del país, mientras que Avangrid se centra en el noreste). Avangrid integrará los ingresos y la infraestructura que posee PNM, y potenciará su oferta de productos renovables (PNM es principalmente generador y distribuidor de energía solar fotovoltaica), generando así sinergias operativas. Iberdrola podrá vender a diferentes territorios geográficos adquiriendo las instalaciones de distribución y los clientes de PNM en zonas no cubiertas por Avangrid.

Sin embargo, la empresa conjunta puede tener mayores recursos y cuota de mercado que sus competidores, lo que le permitirá ejercer un mayor control sobre los precios, aunque estos siempre estén regulados. Esta es la razón por la que NMPRC rechazó temporalmente el acuerdo, en favor de la protección de los clientes.

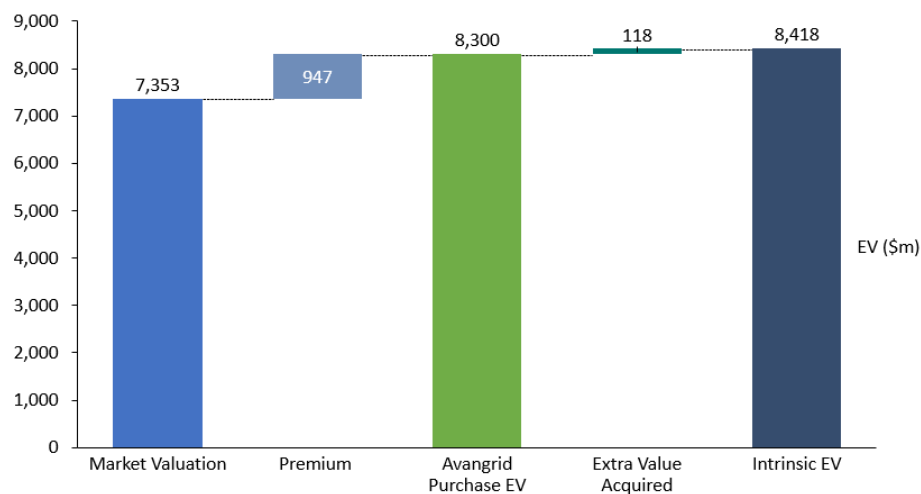
La segunda parte del proyecto se divide en tres secciones: (i) la primera se centra en la situación regulatoria del negocio de Iberdrola en Estados Unidos y sus riesgos y oportunidades, (ii) la segunda analiza el plan estratégico de Avangrid y la justificación de la compra de PNM Resources, y (iii) la tercera sección se centra en la realización de distintas valoraciones de PNM, obteniendo los siguientes resultados:

- A partir del **análisis del mercado**, se obtiene una evolución de cotización de la acción de PNM, de la cual se calcula un Valor de Empresa a 21 de octubre de 2020 (fecha de oficialización de la operación) de **7.353 millones de USD (desde el punto de vista del mercado de capitales)**.
- A partir de los resultados obtenidos con el método de Empresas Comparables, el DCF por el método del Múltiplo de Salida y el DCF por el método de Crecimiento a Perpetuidad, se estima que el Valor de Empresa intrínseco de PNM es de **8.418 millones de USD**.



En definitiva, se puede concluir que la adquisición tiene sentido para Avangrid tras la valoración intrínseca de este proyecto. La prima pagada a los accionistas de PNM en términos de VE es del **12,8% respecto a la valoración del mercado a 21 de octubre del 2020**, mientras que el valor adquirido para los accionistas de Avangrid en la operación asciende a **118 millones de dólares**.

Sin embargo, además de que la operación añade esos 118 millones de dólares de VE a Avangrid, esa cantidad supone un **1,42% del VE de la compra**, que es un porcentaje bajo. Esto, unido a la característica subjetiva del método de valoración DCF, da un **margen muy estrecho a la operación para ser considerada exitosa**.



Por último, una vez concluido el análisis financiero, la tercera parte del proyecto se centra en cómo esta transacción puede contribuir al desarrollo sostenible y medio ambiente.

Se extrae que, efectivamente, esta transacción promueve iniciativas que contribuyen a la consecución de los ODS, especialmente los relativos a **Energía asequible y limpia (ODS 7)** y **Acción por el clima (ODS 13)**, a través de líneas de acción específicas centradas en el acceso universal (ODS 7.1), el incremento de las energías renovables (ODS 7.2) y el desarrollo de medidas para mejorar la eficiencia energética (ODS 7.3); al tratarse de una fusión cuyo objetivo es crear una compañía que impulsaría notoriamente las energías renovables en Estados Unidos.



## Analysis of the Iberdrola – PNM Resources Deal and its Financial and Strategic Impact

Author: Asís Berarducci, Manuel Alejandro

Director: García Jiménez, Luis

### PROJECT SUMMARY

**In October 2020**, Avangrid (NYSE:AGR), the North American subsidiary of Iberdrola (BME:IBE), made an offer to acquire New Mexico-based PNM Resources (NYSE:PNM) in an all-cash transaction at a valuation of USD 8.3 billion Enterprise Value and USD 4.32 billion Equity Value. The shareholders of the target company accepted the proposal based on getting \$50.3 in cash for each common share they owned.



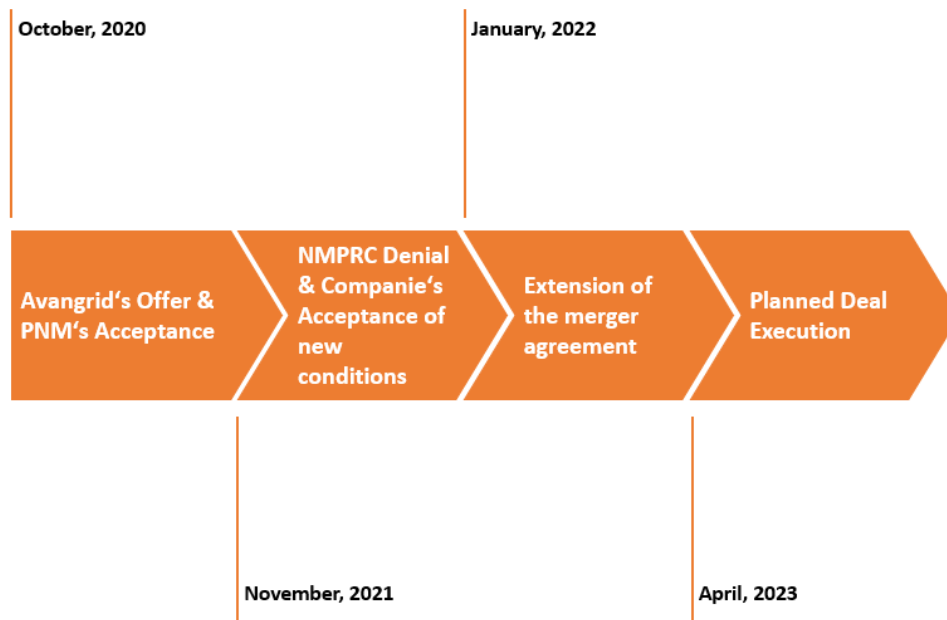
As of today, as many as five federal agencies and the Public Utility Commission of Texas have given the Avangrid proposal the green light. However, the New Mexico Public Regulation Commission (NMPRC), which was the final authority in the permitting process, rejected the deal, voting in favor, following a recommendation by the PRC hearing examiner that the potential risks to consumers outweigh the benefits of the proposal. The examiner added his concerns about potential conflicts of interest in the merged company's corporate structure, ethical issues and Avangrid's "poor" utility track record in the northeastern U.S., where the company operates primarily.

The closing of this transaction therefore remains unresolved. The commissioners did not hold a formal vote on the transaction, and regulators have indicated that they may be open to reopening the case to consider further modifications to the agreement by the companies. Avangrid and PNM announced in November 2021 that they would accept the additional



conditions outlined by the examiner, including corporate governance commitments and additional financial protection for customers.

**On January 3, 2022**, PNM Resources and AVANGRID announced an amendment and extension of their merger agreement until April 20, 2023, as well as an appeal of the NMPRC decision to the New Mexico Supreme Court. There is no legal deadline for the Court to act.



### SCOPE OF THE PROJECT AND RESULTS

The perimeter of this project has been the strategic and financial analysis of the transaction, based on PNM valuations (the target), obtained using different methods and obtaining a final estimate from the different results obtained. From these results, it is possible to compare the offer with the market value and the calculated intrinsic value.

It should be noted that, since these valuations are based on projections, which in turn are subject to assumptions based on the project author's criteria, the results of the intrinsic valuation are subjective.

The project contains a first section divided into two sections: (i) an introductory section on the situation of the transaction, the status of the buyer and the strategic justification of the transaction, and (ii) a second didactic section on the theoretical principles of the valuation methods used, the different M&A transactions and their motivations. This is followed by the execution of the valuations and the analysis of the results.

This first part consists of the following sections:

- Analysis of the current and strategic situation of the buyer (parent and executing subsidiary).
- Intrinsic and relative valuation methods to be implemented in the project (Discounted Cash Flows by (i) Exit Multiple and (ii) Perpetual Growth, and Comparable Companies).
- Analysis of the different strategic reasons for this type of transaction, and identification of the type of acquisition in question: horizontal transaction, i.e. involving two companies operating in the same type of business.

Competition between companies operating in the same sector is usually high, so these types of transactions tend to generate:

- (i) Significant operational synergies and potential market share gains (increased market power). They are a way of eliminating competition by creating one powerful company instead of two competitors, and their main point is the generation of operational synergies, i.e. horizontal mergers can greatly increase

revenues, as the combined companies have access to a wider variety of products or services.

- (ii) Cost synergies from a combination of assets and economies of scale.

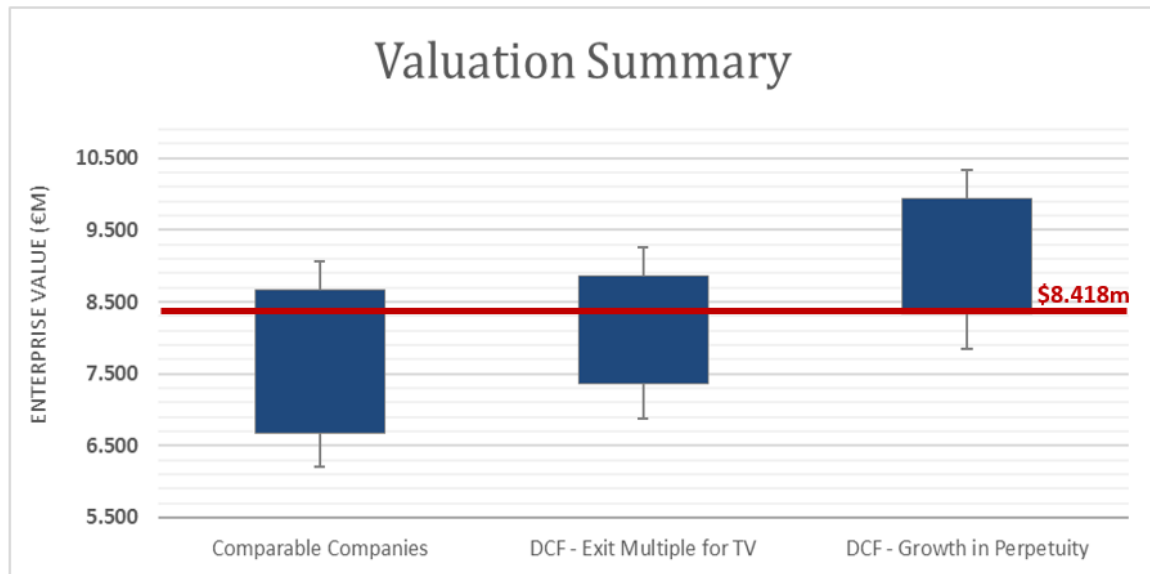
This is the case of the Iberdrola-PNM Resources operation. Iberdrola intends to integrate into its US subsidiary Avangrid one of its competitors in the country (PNM Resources operates in the southwest of the country, while Avangrid focuses on the northeast). Avangrid will integrate PNM's existing revenues and infrastructure, and will leverage its renewable product offering (PNM is primarily a solar PV generator and distributor), generating operational synergies. Iberdrola will be able to sell to different geographic territories by acquiring PNM's distribution facilities and customers in areas not covered by Avangrid..

However, the joint venture may have greater resources and market share than its competitors, which will allow it to exercise greater control over prices, even though these are always regulated. This is why NMPRC temporarily rejected the agreement, in favor of customer protection.

The second part of the project is divided into three sections: (i) the first one focuses on the regulatory situation of Iberdrola's business in the United States and its risks and opportunities, (ii) the second one analyzes Avangrid's strategic plan and the justification for the purchase of PNM Resources, and (iii) the third section focuses on the performance of different valuations of PNM, obtaining the following results:

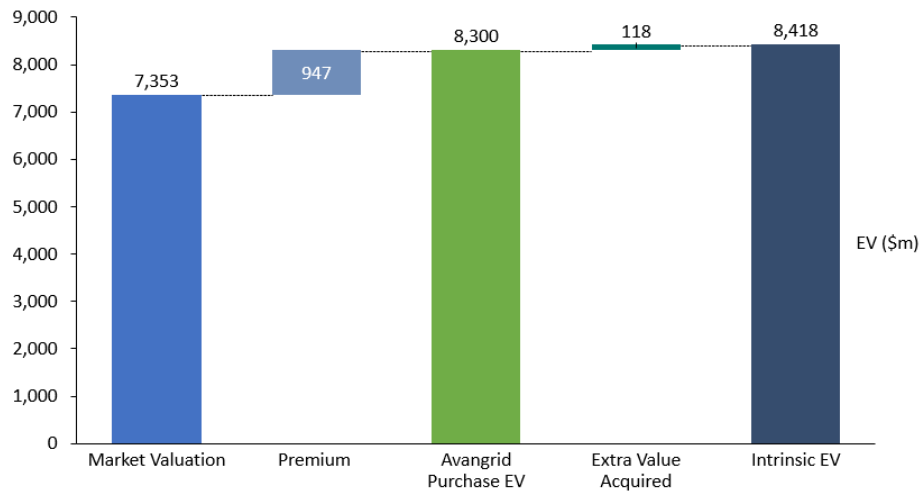
- Based on the **market analysis**, PNM's share price evolution is obtained, from which an Enterprise Value as of October 21, 2020 (date of formalization of the transaction) of **USD 7,353 million is calculated (from the capital market's point of view)**.

- Based on the results obtained with the Comparable Companies method, the DCF by the Exit Multiple method, and the DCF by the Perpetual Growth method, the intrinsic Enterprise Value of PNM is estimated to be **USD 8,418 million**.



All in all, it can be concluded that **the acquisition makes sense for Avangrid** after the intrinsic valuation of this project. The premium paid to PNM shareholders in terms of EV is **12.8% over the market valuation as of October 21, 2020**, while the value acquired for Avangrid shareholders in the transaction amounts to **\$118 million**.

However, in addition to the fact that the transaction adds that \$ 118 million EV to Avangrid, that amount represents **1.42% of the purchase EV**, which is a low percentage. This, coupled with the subjective nature of the DCF valuation method, gives the deal a **very narrow margin to be considered successful**.



Finally, once the financial analysis has been completed, the third part of the project focuses on how this transaction can contribute to sustainable development and the environment.

It is clear that this transaction promotes initiatives that contribute to the achievement of the SDGs, especially those related to **Affordable and Clean Energy (SDG 7)** and **Climate Action (SDG 13)**, through specific lines of action focused on universal access (SDG 7.1), the increase of renewable energies (SDG 7.2) and the development of measures to improve energy efficiency (SDG 7.3); since it is a merger aimed at creating a company that would significantly boost renewable energies in the United States.



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# Chapter 1. *INTRODUCTION*

## 1.1. INTRODUCTION

In October 2020 Avangrid (NYSE:AGR), the North American subsidiary of Iberdrola (BME:IBE), made an offer to acquire the New Mexico-based PNM Resources (NYSE:PNM) in an all-cash deal with an enterprise value of USD 8.3 billion and equity value of USD 4.32 billion. The target's shareholders accepted the proposal to get USD 50.3 in cash for each common share held with an overwhelming majority.



*Figure 1: PNM Resources logo*



*Figure 2: Avangrid logo*

PNM Resources has 3.1 GW of diverse power generation capacity and purchased power resources, including renewables, and supplies electricity to roughly 800,000 homes and businesses in New Mexico and Texas, and it aims to be emissions-free by 2040.

Iberdrola's plan to acquire the company through Avangrid (a company listed on the NYSE which is majority controlled by Iberdrola with an 81.7% stake) aimed to further expand its outreach in the US and create a combined energy company with 10.9 GW of installed capacity that would be the third-largest renewable energy operator in the US.

For the moment, up to five federal agencies and the Public Utilities Commission of Texas have already greenlit Avangrid's proposal. However, the New Mexico Public Regulation

Commission (NMPRC), which was the last clearing authority in the permission process, turned down the deal, voting to reject it, following a recommendation from the PRC hearing examiner that the potential risks to customers outweigh the benefits of the proposal. The examiner added concerns about possible interests' conflicts in the corporate structure of the merged firm, ethical concerns, and the “poor” history of Avangrid’s public services in the northeast of the U.S., where the company mainly operates.

The conclusion of this deal is still unsolved. The commissioners did not hold a formal vote on the transaction, and regulators have indicated they may be opened to reopening the case to consider further modifications to the deal by the companies. Avangrid and PNM said in **November 2021** they would agree to additional conditions outlined by the examiner, including corporate governance commitments and additional financial protection for clients.

**On January 3, 2022**, PNM Resources and AVANGRID announced an amendment and extension of their merger agreement to **April 20, 2023**, and an appeal of the NMPRC decision with the New Mexico Supreme Court. There is no statutory deadline for the Court to act.

The objective of this project is the analysis of this ongoing transaction from a financial perspective to conclude if it makes sense for Avangrid or not.

## **1.2. ACQUIRER DESCRIPTION**

### **1.2.1. AVANGRID**

Avangrid’s operations are developed mainly in the New England area of the US, and divided in two business lines: **Networks**, and **Renewables Generation**. The renewables generation line is composed by **offshore wind, onshore wind, and solar**. Onshore wind is the one that blows from the sea towards the land. On the other hand, offshore wind is the type of wind that blows from the land towards the sea.

### AVANGRID's Net Electricity Production

AVANGRID	2Q 2022			YTD 2022		
	GWh	% Weight	% YoY	GWh	% Weight	% YoY
<b>Renewables</b>	<b>5,692</b>	<b>96%</b>	<b>7.5%</b>	<b>11,083</b>	<b>93%</b>	<b>7.1%</b>
Onshore wind <sup>(1)</sup>	5,543	94%	7.6%	10,837	91%	7.2%
Hydro	52	1%	42.2%	89	1%	26.0%
Solar	79	1%	-8.7%	121	1%	-7.4%
Fuel cells	17	0%	-10.5%	36	0%	-13.6%
<b>Peaking generators</b>	<b>1</b>	<b>0%</b>	<b>-84.0%</b>	<b>1</b>	<b>0%</b>	<b>-76.3%</b>
<b>Klamath Cogeneration<sup>(2)</sup></b>	<b>210</b>	<b>4%</b>	<b>-62.8%</b>	<b>782</b>	<b>7%</b>	<b>-43.2%</b>
<b>TOTAL</b>	<b>5,902</b>	<b>100%</b>	<b>0.7%</b>	<b>11,866</b>	<b>100%</b>	<b>1.1%</b>

Figure 3: Avangrid's Operational Figures 2Q 2022

In terms of financial figures, the Avangrid exposes a clear growth behavior: growth rate in Adjusted EBITDA of +21% (2Q 2022 vs 2Q 2021), and +88% in the Net Income for the same period.

Net Income						
	2Q 2022		vs 2Q 2021	1H 2022		vs 1H 2021
Networks	\$130M		+\$28M (+28%)	\$381M		+\$55M (+17%)
Renewables	\$73M		+\$48M (+191%)	\$281M		+\$148M (+111%)
<b>AVANGRID</b>	<b>\$184M</b>		<b>+\$86M (+88%)</b>	<b>\$629M</b>		<b>+\$197M (+46%)</b>

Adjusted Net Income <sup>1</sup>						
	2Q 2022		vs 2Q 2021	1H 2022		vs 1H 2021
Networks	\$129M		+\$21M (+19%)	\$382M		+\$45M (+13%)
Renewables	\$66M		+\$26M (+64%)	\$277M		+\$113M (+69%)
<b>AVANGRID</b>	<b>\$178M</b>		<b>+\$56M (+46%)</b>	<b>\$628M</b>		<b>+\$152M (+32%)</b>

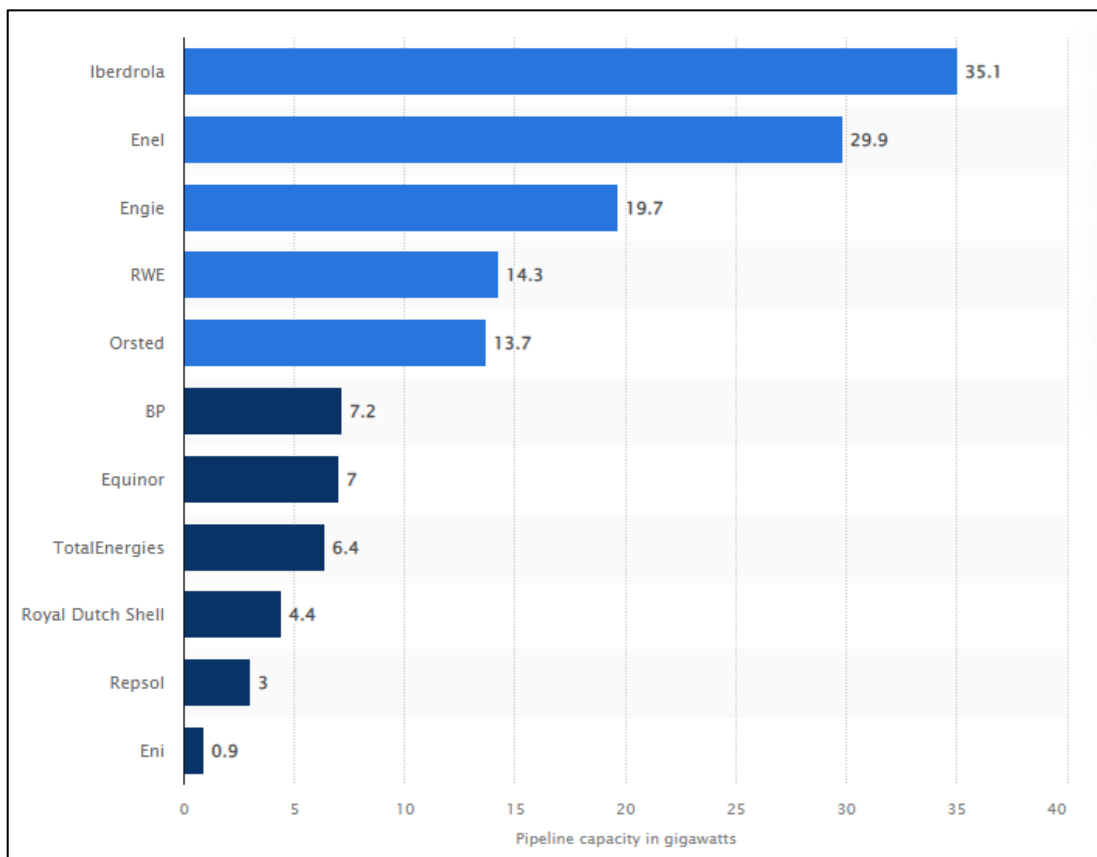
  

Adjusted EBITDA with Tax Credits <sup>1</sup>						
	2Q 2022		vs 2Q 2021	1H 2022		vs 1H 2021
Renewables	\$208M		+\$36M (+21%)	\$366M		-\$77M (-17%)

Figure 4: Avangrid's Adjusted EBITDA and Net Income

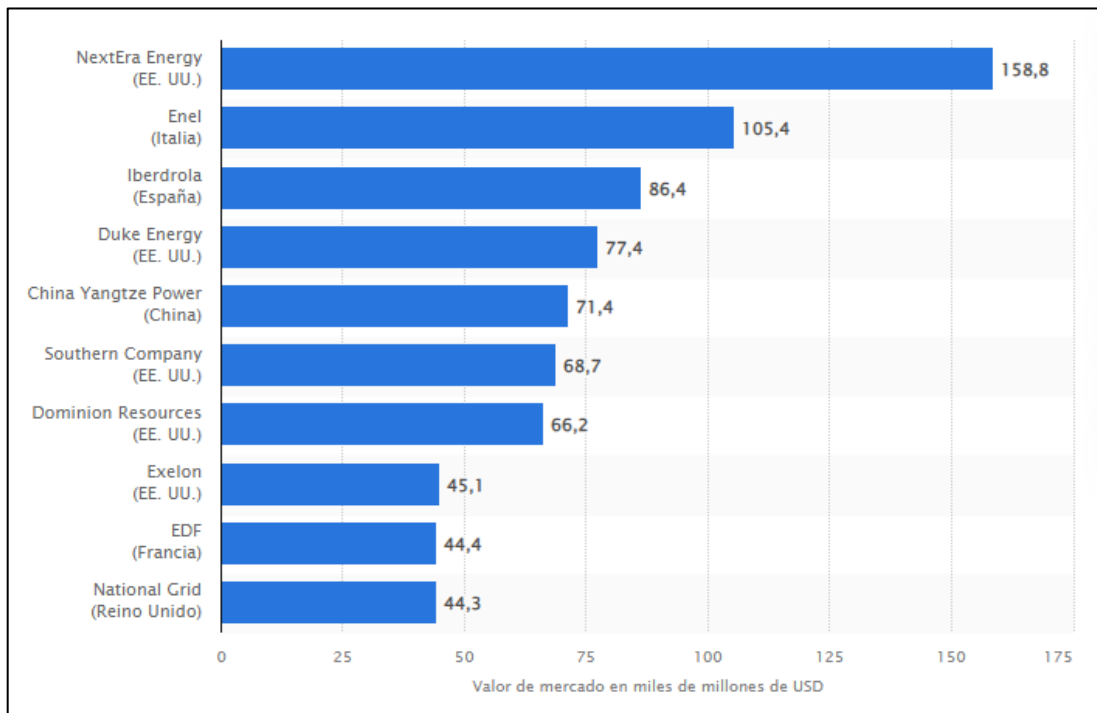
### 1.2.2. IBERDROLA: AVANGRID'S MATRIX

The main activities of Iberdrola involve production of electricity through renewable and conventional sources, purchase and sale of electricity and gas in wholesale markets, transport and distribution of electricity, and sale of electricity, gas, and associated energy services, among other activities mainly linked to the energy sector. The company develops these activities mainly in five countries in the Atlantic area: Spain, the United Kingdom, the **United States (Avangrid)**, Brazil, and Mexico.



*Figure 5: Capacity of renewables project pipeline of leading European energy companies as of November 2020*

Moreover, after the internationalization process carried out in recent years, Iberdrola is today one of the main electricity companies, top-ranked among the largest utilities in the world by market capitalization, sales, and capacity.



*Figure 6: World ranking of the main electricity companies as of April 2021, by market value*

Some of the company data as of today are 58.32 MW of installed capacity, 38.138 MW renewable installed capacity (65%), 164.226 GWh net production, and 36.1 million users.



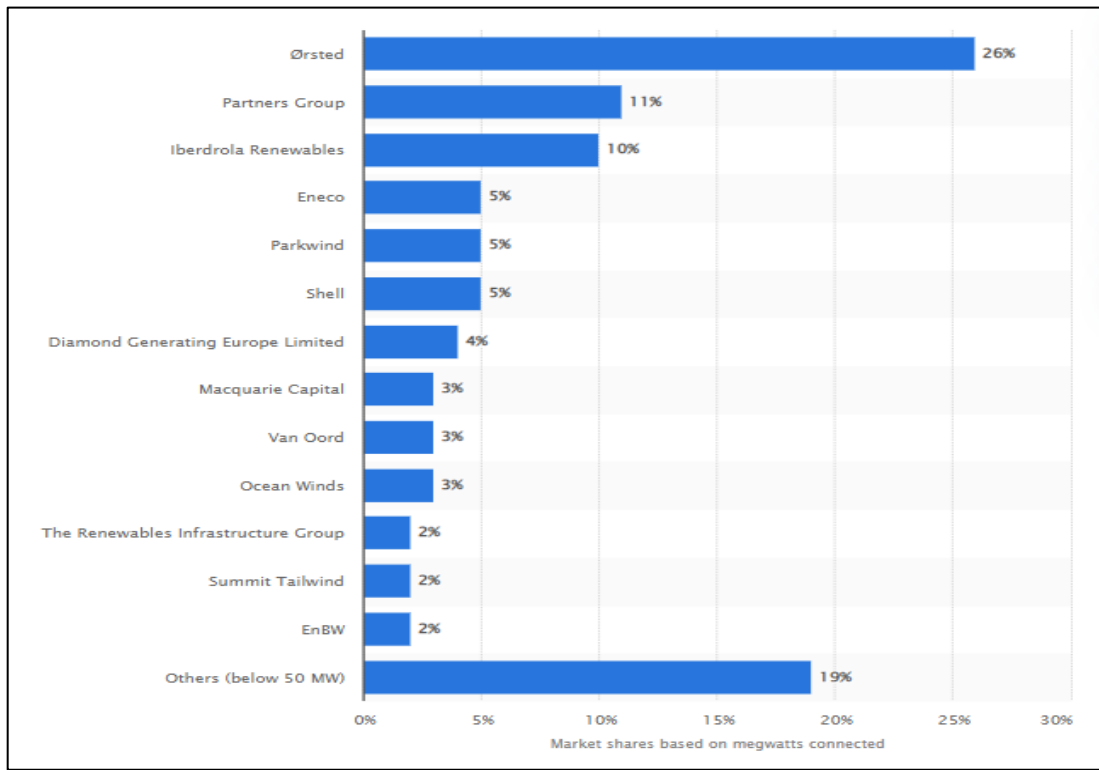


Figure 7: Market share of offshore wind farm developers by annual capacity addition in Europe in 2020



Figure 8: Iberdrola's Key Financials

Iberdrola will perform as the financial supporter for its US subsidiary Avangrid in this deal, and in future projects.

### 1.3. VALUATION METHODS

For this project, the financial models implemented are the predominant valuation methods: Discounted Cash Flow model (DCF), Comparable Companies or Valuation by Multiples, and Precedent Transactions model.

#### 1.3.1. DISCOUNTED CASH FLOW (DCF)

DCF helps determine the value of an investment based on its future cash flows. The present value of expected future cash flows is arrived at by using a discount rate to calculate the

DCF. Companies typically use the weighted average cost of capital (WACC) for the discount rate because it takes into consideration the rate of return expected by shareholders.

DCF model is built normally following these steps:

1. Forecasting the expected cash flow of the company. This step requires projections of the three financial statements (Income Statement, Balance Sheet, and Cash Flow Statement). It is also divided in two parts: one where the growth rate is variable, this part is usually composed by 5 – 10 years of projections, and a second part that goes from the end of the first one to the infinite, and where the growth rate is assumed constant.
2. Discount rate selection, typically based on the cost of financing the investment or the opportunity cost presented by alternative investments. As said before, companies typically use the WACC for the discount rate because it takes into consideration the rate of return expected by shareholders.
3. Discount the forecasted cash flows back to the present day using the discount rate selected.

$$Value = \sum_{t=1}^{\infty} \frac{CF_t}{(1 + WACC)^t}$$

Although DCF is the predominant model in the industry, it also has important limitation that obliges the analyst to compliment the valuation with other techniques, the ones that are exposed below. The main limitation of DCF is that it requires many assumptions. The future cash flows would rely on a variety of factors, such as market demand, the status of the economy, technology, competition, and unforeseen threats or opportunities.

### **1.3.2. COMPARABLE COMPANIES**

Also called Valuation by Multiples, a comparable company analysis (CCA) is a process used to valuate of a company using the metrics of other businesses that are carefully selected as peer companies (companies that are comparable/like the one analyzed in many features).

Comparable company analysis operates under the assumption that similar companies will have similar valuation multiples, such as EV/EBITDA.

It is a good practice in valuation to confirm the DCF results with relative comparisons such as CCA. These relative comparisons allow the analyst to develop an industry benchmark or average.

### **1.3.3. PRECEDENT TRANSACTIONS**

Precedent transaction analysis, another relative comparison, is a valuation method in which the price paid for similar companies (peers/comps) in the past is considered an indicator of a company's value.

This kind of analysis is difficult because it is hard to apply market conditions at the time of a previous valuation or during a certain performance period to a current valuation. However, it is a good tool to use when considering a base line valuation of a company but needs to be bolstered by more intricate analysis.

## **1.4. STRATEGY & M&A MOTIVATIONS**

### **1.4.1. STRATEGIC RATIONALE**

Nowadays, one of the most important aspects for humanity is the future of renewable energies. Societies are trying to move to a more sustainable behavior at all levels, with clear objectives for the next decades, and ESG investment criteria is rising among the most important institutions.

The deal analyzed in this project involves the seventh globally ranked electrical energy company in sales and the most important one in Spain, and PNM which is one of the most promising utilities companies in the southwest of the U.S., with a diverse mix of generation

and purchased power resources totaling 3.1 gigawatts of capacity, intending to achieve 100% emissions-free energy by 2040.

Therefore, the motivation of this project is the understanding of this important transaction in the energy industry, particularly the renewable energy industry, and forecasting the impact of it at a financial, and business level.

### **1.4.2. M&A MOTIVATIONS**

Mergers and acquisitions have played a crucial role in the growth of firms, being growth generally viewed as vital to the well-being of a firm. However, it is not just about growth, the transaction must make sense and generate synergies valued greater than the premium the acquirer pays for the target.

Mergers is the concept that contains any transaction that forms one economic unit from two or more previous ones. There are different types of mergers: horizontal, vertical, and conglomerate mergers. On the other hand, but not too far away, acquisition mean that company X buys company Y and acquires the control.

Another important aspect in these transactions is the way they are carried out, i.e., the acquirer can pay using different assets: shares of the merged firm, typically more valuable than the shares of the target company; cash; or a mix between both.

Some of the reasons of why companies incur in this type of transactions are described below.

#### ***4.2.1 Horizontal integration and operational synergy***

Horizontal M&A deals involve two firms operating in the same kind of business (this is the case of the Iberdrola-PNM Resources transaction analyzed in this project). Competition tends to be high between companies that operate in the same industry, therefore, this kind of deal usually generates meaning operational synergies and potential gains in market share (market power boosting).

They often result in a way to eliminate competition by creating one powerful company instead of two competitors, and its main point is the generation of operational synergies, i.e., horizontal mergers can greatly increase revenues, as the combined companies have access to a greater variety of products or services.

This is the case of the Iberdrola-PNM Resources deal. Iberdrola is looking to integrate in its U.S. subsidiary Avangrid one of its competitors in the country (PNM Resources operates on the southwest of the country while Avangrid is focused on the northeast). Avangrid will acquire the revenues and the infrastructure PNM owns, and boosting its renewable products offer (PNM is mainly a solar photovoltaic generator and distributor), therefore, generating operating synergies. Iberdrola may be able to sell to different geographical territories acquiring PNM's distribution facilities and customers in areas not covered by Avangrid.

However, the newly created company may have greater resources and market share than its competitors, letting the business exercise greater control over pricing. This is the reason why NMPRC turned down temporarily the deal, in favor of the customer protection.

#### ***4.2.2 Vertical integration and cost efficiency***

A vertical merger takes place when firms from different parts of the supply chain consolidate to make the production process more efficient or cost-effective. The main objective of a vertical merger is to improve a company's efficiency or reducing costs. These transactions occur typically when two companies previously selling to or buying from each other combine under one ownership. The businesses are at different stages of production.

#### ***4.2.3 Improvement of acquired companies' management***

There are some cases where companies with important potential are undervalued in the market due to a not optimal management. In some M&A transactions, the acquirer performs a management restructuring, motivated by the consideration that the target's potential is not being taken fully in advantage. This kind of acquisitions are considered hostile, and they are usually triggered by a Public Acquisition Offer (OPA in Spanish).

The investor profile that generally implement this kind of acquisitions is Private Equity. PE funds focus on companies with great potential untapped by the management. PE funds usually hire restructuring firms after the acquisition to boost the management of the target, and therefore generate value.

#### ***4.2.4 Unused tax benefits***

Tax considerations are also involved in mergers. In some instances, a firm with tax losses can shelter the positive earnings of another firm with which is joined. Consequently, the acquiring firm gains value for its shareholders by having to pay less taxes than it would have without the acquisition.

#### ***4.2.5 Use of surplus funds***

When a company successfully faces its debt, i.e., pays its debt interests and principals, it has different investment options for its surplus of liquid financial resources: dividends issuance, and/or reinvestment to generate a better performance of the company (investing in projects with positive NPV).

A third case occurs when the company decides to use this surplus to acquire another firm if the transaction generates value ( $NPV > 0$  and  $WACC > ROIC$ ).

#### ***4.2.6 Combination of complementary resources***

Sometimes, big corporations decide the acquisition of smaller companies because these ones have a product or service with low revenue (low demand of this product/service) but very interesting or even complementary for the acquirer products or services. Another situation that may exist for the target could be that it does not count with enough production or distribution capacity to sell its product(s)/service(s) in a big scale.

#### ***4.2.7 Diversification of the risk and Conglomerates***

Conglomerates are the third type of M&A transactions. It occurs when a company decides to acquire or merge with another firm which belongs to a different industry/business.

Through this technique, the company manages to diversify its businesses, leading to a reduction in the economic risk of the conglomerate



## Chapter 2. *THE TRANSACTION CASE STUDY*

### 2.1. IBERDROLA'S STRATEGIC PLAN & US BUSINESS

#### KEY POINTS

As a world leader in the utilities industry, Iberdrola is positioning itself in the side of ESG interests fighting against climate change. The company ensures the transition to a carbon neutral economy by 2050 is technologically possible, economically viable and socially necessary.

Iberdrola's Climate Action Plan is based on core elements such as technological and business innovation, forming alliances and active participation in the main milestones of the climate agenda as well as support for key initiatives that pursue more ambitious climate goals, raising awareness through both external and internal actions and through collaboration with leading institutions.

Iberdrola's investment plan is committed to developing renewable energy, smart grids, and the geographical and technological diversification of its main business lines (Grids for distribution, Generation and commercialization, Renewables). Its design is based on analyzing future scenarios to test their resilience to the risks and opportunities of climate change.

A review of the climate change risks in 2021 has yielded similar results to previous years, putting the group in a position where the opportunities arising from the decarbonization of the global economy (growth in renewables, investment in smart grids, electrification of transport, green hydrogen, etc.) clearly outweigh the risks. Furthermore, factors such as

advancing the transformation of the business model, asset diversification, experience, and the integration of climate change science into its decision-making process suggest that, overall, Iberdrola’s business model can be classified as resilient to climate change.

### 2.1.1. STRATEGY

The strategy of Iberdrola for the future 30 years goes through a decarbonization process, focusing on ESG criteria implemented at all levels in the company.

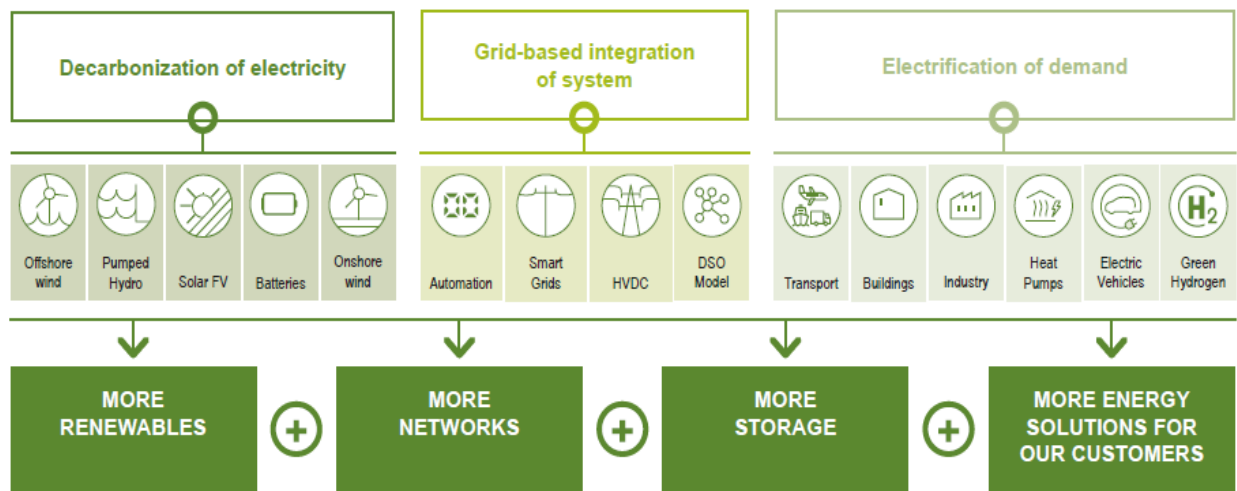


Figure 9: Iberdrola's implementations for its decarbonization-based strategy

Iberdrola’s plan to accelerate value creation will be performed by investing in regulated businesses or businesses with long-term contracts (trying to boost predictable and recurring cash flows), accelerating the growth of the renewable’s activities of the company (mainly offshore wind, photovoltaic and the production of green hydrogen), geographic diversification, the main funding instrument being Green Finance (boosting transparency on impact and use) aligned with the EU Taxonomy.

### 2.1.2. THE REGULATORY ENVIRONMENT IN THE US

The regulatory environment in the countries the company operates offer a positive vision for the future of Iberdrola’s businesses.

In the U.S. and Canada, during his first year in office, President Biden has pushed forward his commitment to reducing emissions by signing several executive orders. Actions include a federal commitment to achieving net zero emissions by 2050, a goal of 100% carbon free electricity by 2030, a commitment to deploy 30 GW of offshore wind by 2030, and a number of electric system security initiatives.

In March 2021, Congress approved the \$1.9 trillion American Rescue Plan to accelerate the pandemic recovery process, and in November 2021, Congress passed the \$1.2 trillion Infrastructure Investment and Jobs Act. It provides funding for a number of areas, including improving resilience of the grid and investment in smart grids, electric vehicle charging infrastructure, clean hydrogen pilot projects, and port upgrades.

The US administration has also launched several regulatory actions to advance its climate and Environmental, Social and Governance (ESG) agenda. These actions include repeal of changes to the licensing rules of the National Environmental Policy Act, requirement for the Securities and Exchange Commission to require climate risk disclosure for listed companies, among other.

### **2.1.3. BUSINESSES: RISKS AND OBJECTIVES**

#### ***1.3.1 Networks business***

Main activities:

In the U.S. continued development of a transmission and distribution network that allows for achievement of the electrification and decarbonization objectives, promoting the integration of renewables, improving resilience and increasing the quality of customer service.

Objectives:

- Zero accidents.

- Offer our customers excellent service based on the quality of supply and information regarding the grid.
- Maximize efficiency in the operation of the system through operational excellence and the digitalization of our assets.
- Lead the energy transition towards a cleaner model favoring a more efficient integration of electric power (centralized and distributed) and the deployment of electric vehicles and heat pumps, using smart grids.

Significant risks:

- Operational risks: impacts on supply because of meteorological events and work-related and third-party accidents at owned facilities.
- Technological and cybersecurity risks affecting the security of the facilities and service to our customers.

### ***1.3.2 Electricity production business***

Main activities:

Exactly 3,484 MW of new installed capacity was added during 2021 (net increase of 3,215 MW):

- Onshore wind: 68 MW in Spain, 224 MW in the United States.
- Photovoltaic solar: 103 MW in the United States.

Iberdrola also has approximately 6,300 MW currently under construction in the US:

- Onshore wind: more than 1,300 MW in Spain, **the United States**, Brazil, Greece, Poland and Australia,
- Photovoltaic solar: more than 2,200 MWdc in Spain, **the United States**, the United Kingdom, Brazil, Australia, Italy, and Portugal.
- Offshore wind: Growth continues with the construction of the 806 MW Vineyard Wind and 804 MW Park City project in the **United States**.

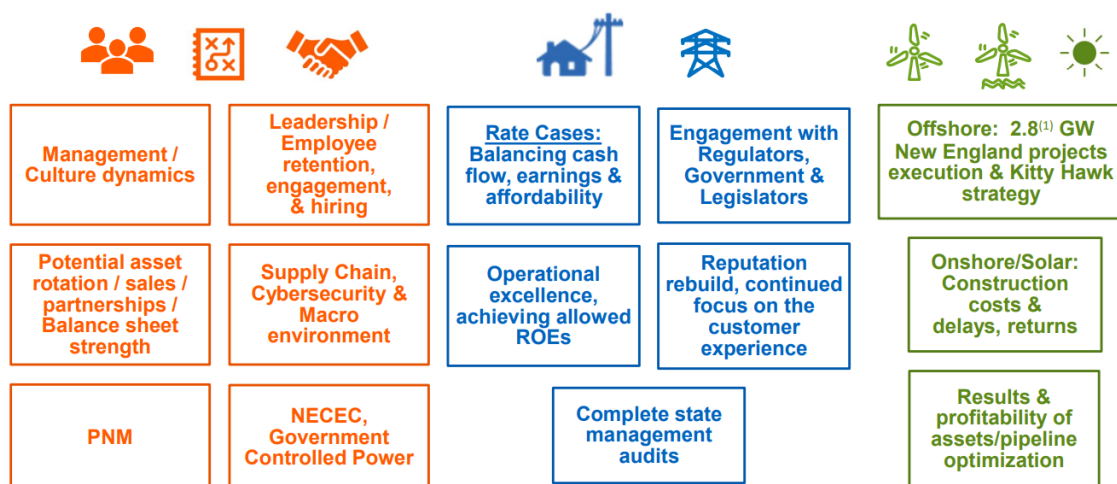
- In addition, work continues to develop new projects, including the 1,232 MW Commonwealth Wind project in the United States, which were awarded during the year.

## 2.2. AVANGRID’S STRATEGY

Avangrid, AGR (NYSE) with ~\$18b market cap., is the US Subsidiary of Iberdrola (the matrix of Iberdrola Group) that operates in the New England area of the country. Avangrid accounts with ~\$40b assets distributed over 24 states, 8 utilities in northeastern states (NY, CT, ME, MA), ~9,1GW of installed capacity of which 8,3GW are renewables (91%), and more than 7 million of people served with 3,3 million customers, among other figures.

Avangrid’s operations are divided in two business lines: **Networks**, and **Renewables Generation**. The renewables generation line is composed by **offshore wind, onshore wind, and solar**. Onshore wind is the one that blows from the sea towards the land. On the other hand, offshore wind is the type of wind that blows from the land towards the sea.

The key areas of focus for the Avangrid’s management are shown below:



*Figure 10: Avangrid's Key Objectives*

Avangrid is a company in a clear growth stage as its figures can show:

Net Income	1Q '22	vs. 1Q '21
Networks	\$252M	+\$27M (+12%)
Renewables	\$208M	+\$100M (+93%)
<b>AVANGRID Consolidated<sup>(1)</sup></b>	<b>\$445M</b>	<b>+\$111M (+33%)</b>

Adjusted Net Income <sup>(2)</sup>	1Q '22	vs. 1Q '21
Networks	\$254M	+\$25M (+11%)
Renewables	\$211M	+\$88M (+72%)
<b>AVANGRID Consolidated<sup>(1)</sup></b>	<b>\$450M</b>	<b>+\$96M (+27%)</b>

#### NETWORKS

- + NY/ME rate increases
- + Capitalization of personnel expense
- + Effective tax rate
- Business costs / personnel / depreciation (primarily related rate plans and investments)

#### RENEWABLES

- + Offshore wind gain: New England partnership restructuring
- + Wind production / margin contribution
- Strong performance during 1Q '21 Texas weather event
- Thermal and asset management / increased depreciation

Figure 11: Double-digit Avangrid's Growth

	Three Months Ended March 31, 2022			
	AVANGRID CONS	Networks	Renewables	Corporate*
	<i>(in millions)</i>			
<b>Net Income Attributable to Avangrid, Inc.</b>	<b>\$ 445</b>	<b>\$ 252</b>	<b>\$ 208</b>	<b>\$ (15)</b>
<b>Adjustments:</b>				
Mark-to-market earnings - Renewables	3	—	3	—
Impact of COVID-19 (1)	2	2	—	0
Income tax impact of adjustments (2)	(2)	(1)	(1)	(0)
<b>Adjusted Net Income</b>	<b>\$ 450</b>	<b>\$ 254</b>	<b>\$ 211</b>	<b>\$ (15)</b>
Net (loss) income attributable to noncontrolling interests	(18)	1	(19)	—
Income tax expense (benefit)	70	32	42	(4)
Depreciation and amortization	261	161	100	—
Interest expense, net of capitalization	71	50	3	18
Other (income) expense	(11)	(12)	(1)	2
(Earnings) losses from equity method investments	(253)	(3)	(250)	—
<b>Adjusted EBITDA</b>	<b>\$ 569</b>	<b>\$ 482</b>	<b>\$ 85</b>	<b>\$ 2</b>
Retained PTCs/ITCs	43	—	43	—
PTCs allocated to tax equity investors	29	—	29	—
<b>Adjusted EBITDA with Tax Credits</b>	<b>\$ 641</b>	<b>\$ 482</b>	<b>\$ 158</b>	<b>\$ 2</b>

Figure 12: Some FY22 Avangrid's Figures by Business Line

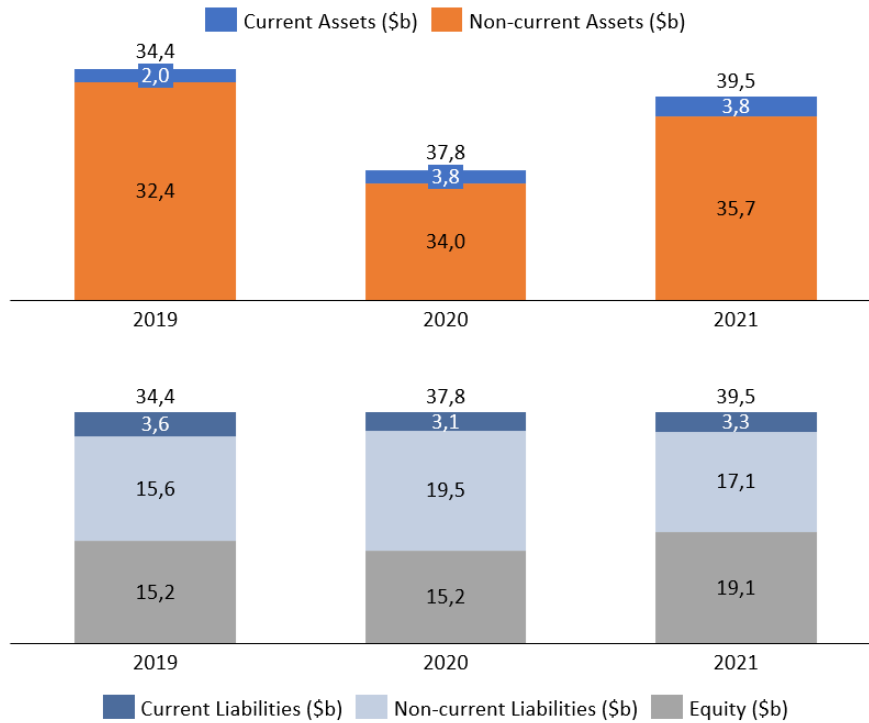


Figure 13: Avangrid's Balance Sheet Evolution (Summary)



Figure 14: Avangrid's Stock Price Evolution

The key opportunities and risks that the company can take advantage of and face respectively in a near future are: the wind production growth, the availability and operational performance requirements in the US networks (improving maintenance performance to prevent outages and storm disasters, and contingent plans to face them), the increasing prices (without forgetting that utilities is a regulated business where the final customer is protected), the inflation and interest rates, and labor costs.

### **2.2.1. AVANGRID-PNM RATIONALE**

The merger of PNM apparently fits within the Iberdrola's strategy key objectives: (i) growth in regulated businesses and renewables, (ii) increase exposure in highly rated countries (AAA), (iii) accretive transactions to earnings from the first year, and (iv) maintaining balance sheet strength.

This deal also satisfies some PNM management requirements such as being an all-cash transaction that would provide certainty of value to PNM Resources shareholders, being an immediately accretive to combined entity earnings per share in first full year after closing, and a combined entity that improves PNM Resources credit profile with greater financial flexibility and lower cost of capital.

Moreover, PNM operates in:

- New Mexico: PNM serves the main cities of this state (Albuquerque, Santa Fe, Belen, Las Vegas, Rio Rancho)
- Texas: PNM serves mainly development areas around Dallas and Houston such as Lewisville, League City, Texas City, and Friendswood.

These are states where Iberdrola Group already does business, and therefore suppose a good combination opportunity for Avangrid:

- Wind operational assets in New Mexico (604MW).
- Wind operational assets and retail business in Texas (1.256MW).



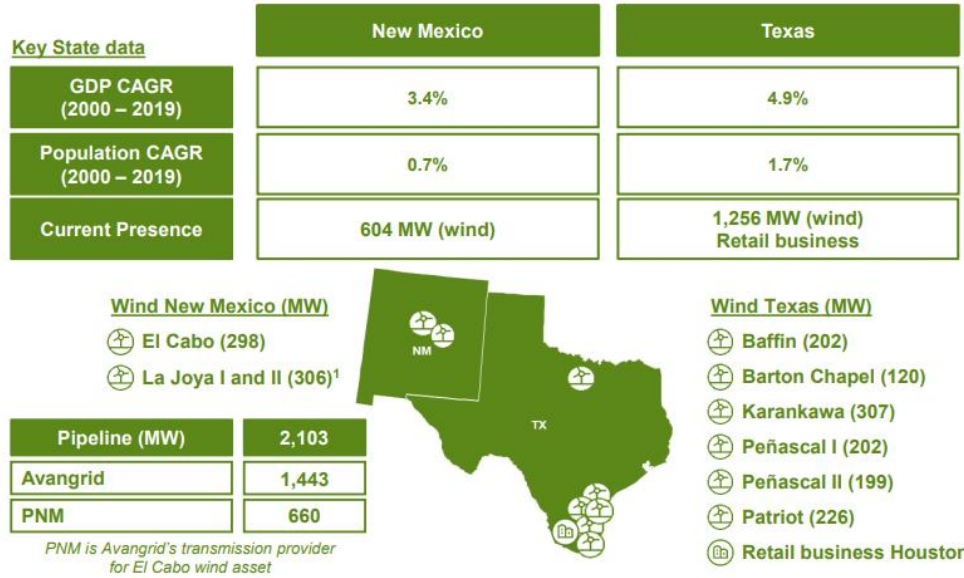


Figure 15: Current Avangrid's Activities in NM and TX

The combined company will create a NewCo with 10 regulated utilities, operations in 24 states, installed capacity of ~10,9GW, and more than 168.000 km of T&D (transmission & distribution) lines.

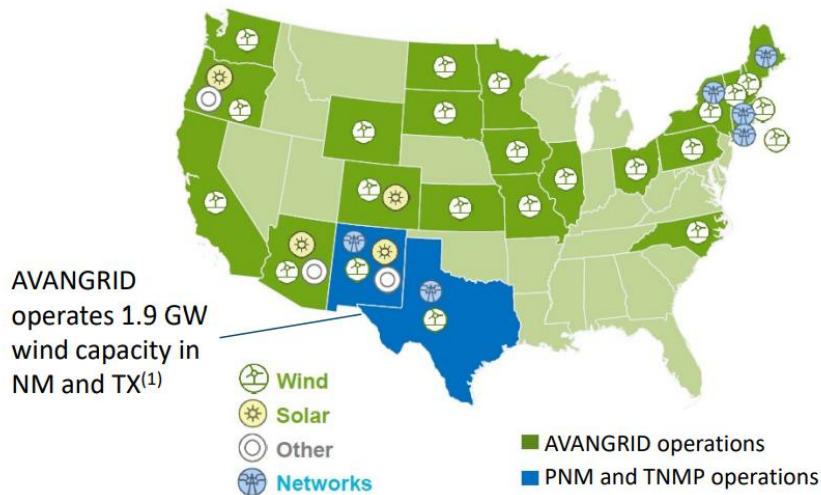


Figure 16: Avangrid + PNM Locations

### 2.1.1 PNM Resources Description

PNM Resources (publicly traded on the New York Stock Exchange as PNM, with a Market Cap. of \$4,1b, and traded at \$47,86 per share as of August 26, 2022) is the state of New Mexico’s largest energy provider, powering more than 525,000 residential and business customers across the state through solar, wind, and geothermal generation.

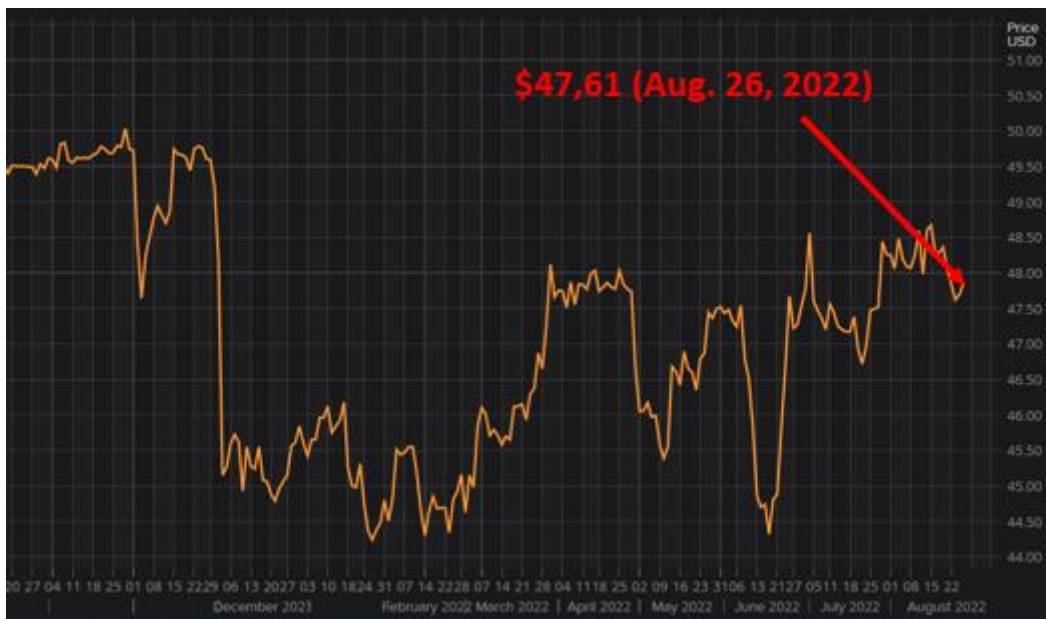


Figure 17: PNM's Stock Price Evolution

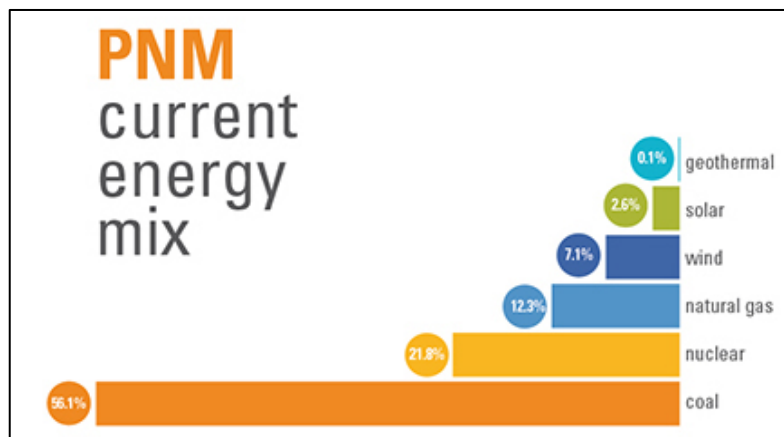


Figure 18: PNM current energy mix

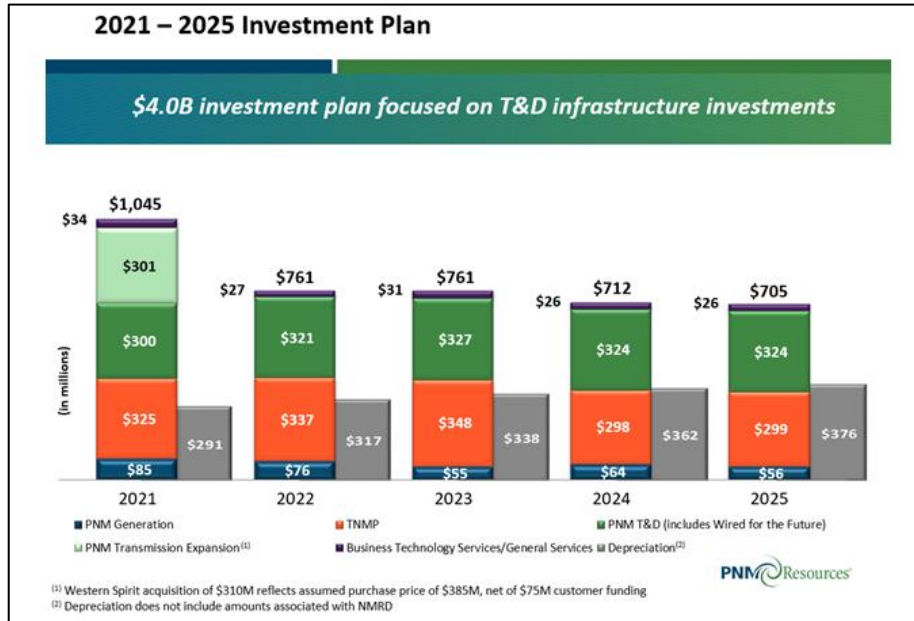


Figure 19: PNM's investment plan

As a regulated utility, PNM Resources achieves earnings growth by investing in infrastructure that provides long-term value to customers and earning the authorized return on these rate base investments.

Some of its key figures and rating are exposed below:

FINANCIAL SUMMARY >			
	LTM 29-Aug-22	HISTORICAL	
		FY-1	FY0
Revenue	1.93	1.52	1.78
Growth	19.07%	4.49%	16.87%
Gross Income	—	—	—
Margin	—	—	—
EBITDA	0.68	0.60	0.63
Margin	34.73%	39.46%	35.37%
EBIT	0.35	0.29	0.31
Margin	17.38%	18.80%	17.38%
Net Income	0.16	0.17	0.20
Margin	7.42%	11.34%	11.00%
EPS	1.81	2.15	2.27
Growth	-26.42%	122.46%	5.70%

Figure 20: PNM's P&L Summary (\$b)

(In millions)	Dec. 31, 2021	June 30, 2022
<b>Long-Term Debt (incl. current portion) <sup>(1)</sup></b>		
PNM	\$1,881.1	\$1,850.1
TNMP	918.1	983.0
Corporate/Other	899.7	999.6
<b>Consolidated</b>	<b>\$3,698.9</b>	<b>\$3,832.7</b>
<b>Total Debt (incl. short-term) <sup>(1,2)</sup></b>		
PNM	\$1,888.5	\$1,960.9
TNMP	918.5	1,083.0
Corporate/Other	954.6	1,055.1
<b>Consolidated</b>	<b>\$3,761.6</b>	<b>\$4,099.0</b>

Figure 21: PNM's Balance Sheet Information

PNMR Consolidated	S&P	Moody's
Issuer rating	BBB	Baa3
Outlook	Positive	Stable
Senior unsecured rating	BBB-	Baa3

*Figure 22: PNM's Current Rating*

This company is in clear expansion, planning to reach a large portion of the U.S. southwest territory in the next five years. PNM's rate base growth is driven by investments to support customer demand and load growth at both of its subsidiaries, **PNM and TNMP** and expansion of its transmission grid to deliver clean energy, enhance customer satisfaction and increase grid resilience. The company's current capital forecast calls for \$4.0 billion worth of investments in the years 2021 through 2025.

PNM is currently trading at a P/E ratio of 20.06, which exposes how the market sees with an optimistic perspective the future of this company.

PNM Resources serves electricity to approximately 800.000 homes and businesses in New Mexico and Texas through its regulated utilities, PNM and TNMP, with a diverse mix of generation and purchased power resources totaling 3.0 gigawatts of capacity, with a goal to achieve 100% emissions-free energy by 2040.

It is important to remark that both Avangrid and PNM Resources are regulated utilities.

Utility companies often hold "natural monopolies" over a certain service even when they are privately owned. To compensate for this, government regulations heavily superintend public utilities to protect consumers against undesirable monopolistic practices. Government agencies can regulate the prices utility companies charge their customers, their budgetary process, their ability to construct new facilities, the services they are allowed to offer, and their energy efficiency programs.

In the United States, utility companies are regulated at the state and municipal levels by public service commissions. A power purchase agreement (PPA) is a contract a private utility company enters into with a government agency to provide power over an extended period of time.

Typically, however, to compensate for the monopoly, **state commissions set the rates for service, which are calculated from the price plus what the commission deems a reasonable return on investment**, and they reserve the authority to make the company enact some service improvements. The companies are required to offer the service to those living in their territory.

		PNM		TNMP	
		T&D and Generation	Transmission Service (FERC)	T&D	Transmission Cost of Service
Regulatory Metrics	ROE	9.575%	10.00%	9.65%	
	Reg. Cap.	Debt / Equity: 50% / 50%		Debt / Equity: 55% / 45%	
Next Rate Case Date		01/07/2022 <sup>1</sup>	Annual	<ul style="list-style-type: none"> <li>▪ Transmission: semiannually</li> <li>▪ Distribution: annually</li> <li>▪ General Rate Case: TBD</li> </ul>	

Figure 23: PNM's Regulatory Status Overview

### 2..1.1.1 PNM

As said before, PNM is a regulated utility in New Mexico with operations primarily engaged in the generation, transmission, and distribution of electricity. PNM's capacity in electric generating facilities, which are owned, leased, or under Power Purchase Agreements, in commercial service as of March 31, 2021 is:

Type	Name	Location	Generation Capacity (MW)
Coal	SJGS	Waterflow, New Mexico	562
Coal	Four Corners	Fruitland, New Mexico	200
Gas	Reeves Station	Albuquerque, New Mexico	146
Gas	Afton (combined cycle)	La Mesa, New Mexico	235
Gas	Lordsburg	Lordsburg, New Mexico	85
Gas	Luna (combined cycle)	Deming, New Mexico	190
Gas/Oil	Rio Bravo	Albuquerque, New Mexico	149
Gas	Valencia Energy Facility	Belen, New Mexico	155
Gas	La Luz	Belen, New Mexico	41
Nuclear	PVNGS	Wintersburg, Arizona	402
Solar	PNM-Owned Solar	Twenty-four sites in New Mexico	158
Solar	NMRD-Owned Solar	Los Lunas, New Mexico	130
Wind	Casa Mesa	De Baca and Quay Counties, New Mexico	50
Wind	NM Wind Energy Center	House, New Mexico	200
Wind	Red Mesa Wind Energy Center	Seboyeta, New Mexico	102
Wind	La Joya Wind I	Encino, New Mexico	166
Geothermal	Lightning Dock Geothermal	Lordsburg, New Mexico	11
			<b>2,982</b>

As of March 31, 2021

Figure 24: PNM Generation Capacity in NM

In terms of T&D lines, As of December 31, 2020, PNM owned, jointly owned, or leased, **3.389 circuit miles** of electric transmission lines (including the Eastern Interconnection Project); **6.077 miles** of distribution overhead lines; **5.962 cable miles** of underground distribution lines (excluding street lighting); and **255 substations**.

PNM Customers	
Residential	479,112
Commercial	57,669
Industrial	194
Economy Service	1
Other sales for resale	19
Other	935
<b>Total PNM Customers</b>	<b>537,930</b>

Figure 25: PNM's customer split

### 2..1.1.2 TNMP

TNMP provides transmission and distribution services in Texas under the provisions of Texas Electric Choice Act (TECA) and the Texas Public Utility Regulatory Act. TNMP's transmission and distribution activities are solely within the Electric Reliability Council of Texas (ERCOT), which is the independent system operator responsible for maintaining reliable operations for the bulk electric power supply system in most of Texas.

As of December 31, 2020, TNMP owned **983 circuit miles** of overhead electric transmission lines; **7,282 pole miles** of overhead distribution lines; **1,348 circuit miles** of underground distribution lines; and **110 substations**.

TNMP End-Users	
Residential	217,511
Commercial	41,267
Industrial	97
Other	1,901
<b>Total TNMP End-Users</b>	<b>260,776</b>

*Figure 26: TNMP customer split*

## 2.3. PNM VALUATION

### 2.3.1. PNM MARKET VALUATION

The first valuation to consider is the one that the market does about PNM Resources.

It can be seen in the PNM's Stock Price Evolution figure, shown in the previous section, that on **October 21, 2020** (date when the PNM's makes the deal official) the company's stock price is \$49,9 per share, while it is **\$47,61 per share as of August 26, 2022**.

In terms of Enterprise Value, on October 21, 2020 PNM was valued with **\$7.353m**.



### 2.3.2. DCF

The DCF Method consists of discounting estimated future cash flows at a discount rate. It is here, where a variety of different methodologies appear for its calculation. However, since the focus of the project is analyzing an M&A transaction and not the valuation from an investor's point of view, we will use the following methodology:

Using free cash flow and WACC. This way, the value of the debt plus that of the capital is equal to the present value of the expected free cash flows that the company will generate, discounted at the weighted average cost of capital.

In addition, for the DCF, it will be necessary to estimate and value various concepts:

- Weighted Average Cost of Capital (WACC)
- Cost of Equity ( $k_e$ )
- Beta ( $\beta$ )
- Unlevered Free Cash Flow (UFCF)

#### ***3.2.1 Weighted Average Cost of Capital (WACC)***

The weighted average cost of capital (WACC) represents a firm's average cost of capital from all sources, including common stock, preferred stock, bonds, and other forms of debt. It is a common way to determine required rate of return because it expresses, in a single number, the return that all the investors of the company require (both bondholders and shareholders) to provide the company with capital.

Since WACC represents a weighted average of the cost of the funds, it is composed of two or three magnitudes:

- The cost of the equity ( $k_e$ ), which represents how risky the market sees the company and therefore the required return the stock investors demand in exchange for acquiring a share
- The cost of the debt ( $k_d$ ) represents how risky the company is considered by debt investors (merchant banks, bondholders...) and therefore the debt interest/yield required for those investors.
- The cost of preferred stocks ( $k_p$ ) which represents the same as the other two magnitudes but only for preferred stock investors.

$$WACC = \left( \frac{E}{V} \times k_e \right) + \left( \frac{D}{V} \times k_d \times (1 - t) \right) + \left( \frac{P}{V} \times k_p \right)$$

Where:

E = Market value of the firm's equity

D = Market value of the firm's debt

P = Market value of the firm's preferred stocks

V = E + D + P

t = Corporate tax rate

In this project, since the objective is to calculate the intrinsic value of PNM Resources for Avangrid, the discount rate must be the **Avangrid's WACC**.

The magnitude E will be calculated as the Avangrid's Market Capitalization, as the number of fully diluted outstanding shares times the market price per share as of August 26, 2022. Both the Equity and the Debt (D) will have to be valued at market value whenever possible.

For simplicity, the part related with the preferred stocks can be neglected in this case.

To estimate the WACC for Avangrid, the first step is the estimation of the portions E, D, and V. E (Equity) is calculated by multiplying the number of outstanding shares and the share price in the New York Stock Exchange on August 26<sup>th</sup> of 2022.

(\$m)	
Avangrid	
MC	19.609
Debt	8.474
V	28.083
ke	7,2%
kd (a-t)	3,90%
WACC	6,2%

Figure 27: Avangrid's WACC Q1 2022 (Bloomberg)

To calculate D Subsequently, the memory data is obtained, both for the company's short-term and long-term debts in the various currencies in which it operates.

The percentages are calculated below:

<b>E (M€)</b>	19.609
<b>D (M€)</b>	8.474
<b>V (M€)</b>	28.083
<b>E/V</b>	<b>69,8%</b>

<b>D/V</b>	<b>30,2%</b>
------------	--------------

*Table 1: Avangrid's Equity and Debt portions*

### 3.2.2 Cost of Equity ( $k_e$ )

The typical calculation for the cost of equity is by using the Capital Asset Pricing Model (CAPM). The CAPM is an investment theory that attempts to explain the relationship between the expected return of an investment and market risk. Its formula is below:

$$k_e = r_f + \beta * (r_m - r_f)$$

Where:

$r_f$  = risk-free rate

$\beta$  = beta

$r_m$  = expected market return

Once the different terms of the CAPM formula to calculate the cost of equity are known (from the Bloomberg terminal of Universidad Pontificia Comillas, on May 17<sup>th</sup>, 2022):

<b><math>r_f</math> (U.S. Treasury – 10 years)</b>	<b>2.118 %</b>
<b><math>r_m</math> (NYSE)</b>	<b>13,7 %</b>
<b><math>\beta</math></b>	<b>0.37</b>
<b><math>k_e</math></b>	<b>6,2 %</b>

Table 2: Avangrid's Cost of Equity

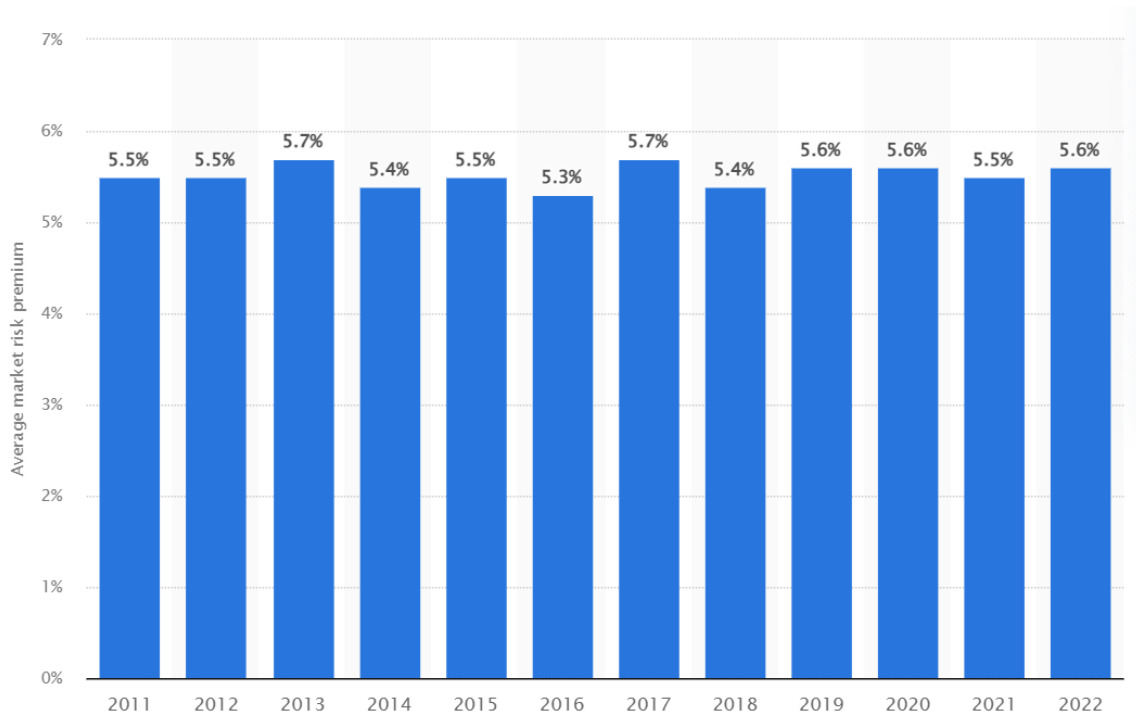


Figure 28: Average US Market Risk Premium Evolution (Statista)

### 3.2.3 Cost of Debt ( $k_d$ )

The cost of debt ( $k_d$ ) is estimated based on the interest rate paid on any debt the company has, which on its own can vary quite significantly depending on the approach used. Regardless, the pre-tax cost of debt number must be multiplied by the tax shield  $(1 - t)$  because interest expense is a tax-deductible item in most countries.

In the case of Avangrid, the cost of debt selected is the one that applies to Iberdrola, since Avangrid's operations are financed mainly by Iberdrola's financial muscle.

To estimate the cost of debt it should be used the YTM of last bonds issued by the company, however, for simplicity, in this project the cost of debt is calculated by dividing the finance expense by the debt of the company. The financial expenses of the company and the number of external resources that the company has (Debt that has already been used previously) are

obtained through the 2021 Iberdrola's Financial Report. Dividing these expenses by the debt and multiplying it by (1-tax rate), we get the after-tax cost of debt. The tax rate has been chosen at 23,87% which is the tax rate calculated as EBT divided by income taxes in FY21.

$$k_d = \frac{\text{Finance Expense}}{\text{Debt}}$$

<i>Finance Expense (M€)</i>	2,268.00
<i>Debt (M€)</i>	44,093.00
<i><math>k_d</math></i>	<b>5.14%</b>
<i>Tax Rate</i>	23,87%
<i><math>k_d \times (1 - t)</math></i>	<b>3,9%</b>

Table 3: Avangrid's / Iberdrola's Cost of Debt

### 3.2.4 Beta ( $\beta$ )

Beta ( $\beta$ ) is a measure of volatility, not risk. It's not a measure of total risk, but of market fluctuation related risk. In other words, beta tells you how much a stock price moves relative to the overall market (in this case to the IBEX35). However, according to the CAPM, beta is the only relevant measure of a stock's risk.

$$\beta = \frac{\text{Covariance}(re, rm)}{\text{Variance}(rm)}$$

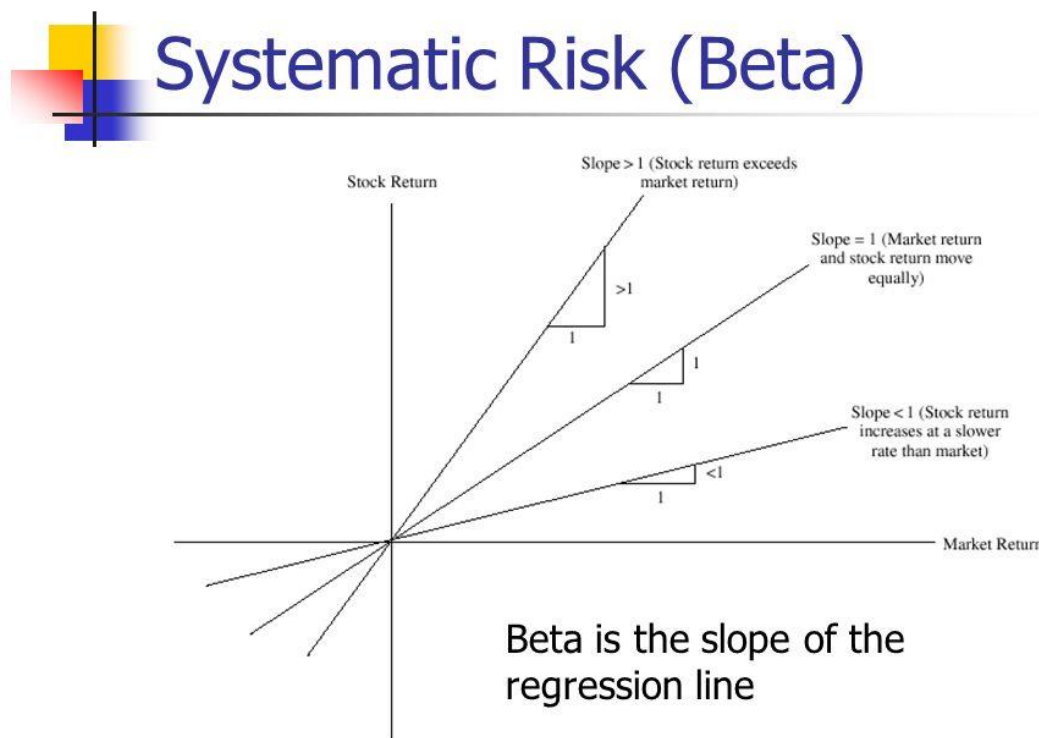
where:

$r_e$  = return on individual stock

$r_m$  = return on overall market

Covariance = stock's return relative to the overall market

Variance = how the market moves relative to its mean



*Figure 29: Beta explanation*

The value of  $\beta$  determines the risk-return relationship of the company:

- $\beta < -1$ : means the stock price is more volatile than the market and moves in the opposite direction of the market.
- $-1 < \beta < 0$ : means the stock price is less volatile than the market and moves in the opposite direction of the market.

- $\beta = 1$ : Risk and return are in balance and stock price has the same volatility as the market.
- $0 < \beta < 1$ : Stock price is less volatile than the market and moves in the same direction of the market.
- $\beta > 1$ : Stock price is more volatile than the market and moves in the same direction of the market.

For the calculation of the beta, the historical data of the daily prices of Avangrid and the NYSE, from the period 2012-2022, will be used and the daily variations of said prices will be calculated. Subsequently, the covariance of the daily variations of Avangrid from January 1, 2012, with respect to the NYSE is calculated and divided by the variance of the NYSE.



Figure 30: Avangrid's Beta

$\beta$	0.37
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Table 4: Avangrid's Beta



### 3.2.5 Free Cash Flow to Firm (FCFF)

Free cash flow to firm shows how much cash is available to the firm before taking financial obligations into account. FCFF is of interest to this project (M&A and strategic analysis) since it indicates how much cash a business has to expand.

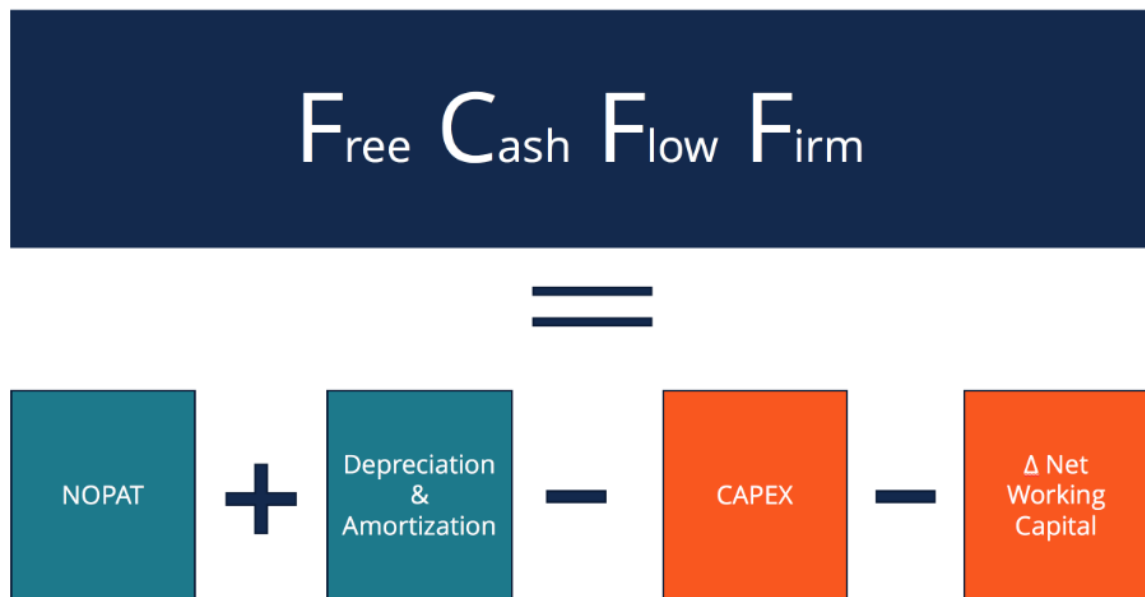


Figure 31: Free cash flow to firm calculation

Where:

- NOPAT = Net Operating Profit After Taxes =  $EBIT \times (1 - \text{tax rate})$
- D&A = Depreciation and Amortization expense
- CAPEX = Capital Expenditure
- $\Delta$  Net OWC = Changes in Net Operating Working Capital

Once the discount rate (WACC) has been calculated, it is necessary to make a series of estimations based on market forecasts and Iberdrola's action plan in the short/medium term that we discussed earlier "Strategic Plan". Therefore, the magnitudes that affect the cash

flows (NOPAT, D&A, CAPEX,  $\Delta$  Net OWC) of the coming years are the ones that will be predicted.

Firstly, to find the projections of the NOPAT it is necessary to project Revenues and all the operating expenses to find the EBIT's projections. To do so, market research was developed to estimate the growth rate in terms of demand, industry revenue, and the company revenue.

Electricity demand is estimated to double by 2050, therefore driving energy efficiency.

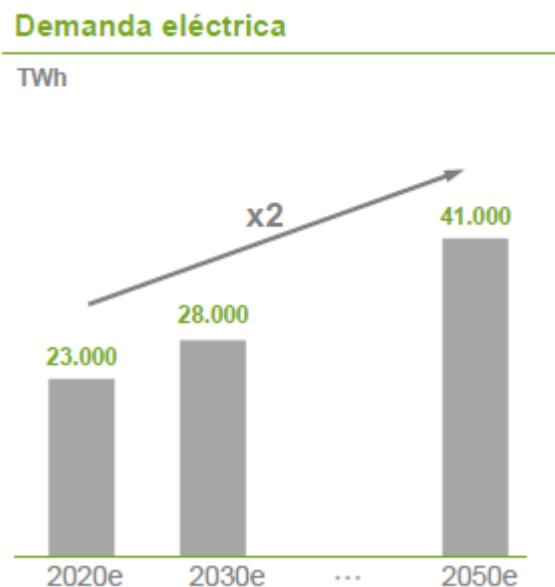


Figure 32: Predictions for electric demand by 2050

### 3..2.5.1 Synergies

There are two different types of synergies generated from this deal:

- (i) **Operational synergies** from businesses combination, based on (i) **revenue increase** through growing NM and TX electric demand coupled with Avangrid expertise in the renewables and networks management, (ii) **costs reduction** through exploitation of renewable generation and network assets of both companies optimizing labor costs.

These operational synergies are quantified as below:

- Projected revenue growth of **0,7%** annually over the projections without taking in account synergies, due to Avangrid management expertise in negotiating with regulatory entities to obtain better terms for electricity rates.
  - Projected COGS with a reduction of **0,6%** annually over the projections without taking in account synergies, due to Avangrid management expertise in renewables generation and T&D networks applied to PNM assets' operations that will improve company efficiency.
- (ii) **Financial synergies** since the combined entity will improve PNM Resources growth opportunities due to a stronger financial profile well positioned for growth opportunities, supported by the unparalleled global resources of Iberdrola. These synergies will impact two different figures in the projections:
- Projected revenue will grow at a **1%** over the projections without taking in account this synergy.
  - Capex will grow in the short term at a **1,6%** over the projections without taking in account this synergy.

Assumptions in terms of P&L figures such as Net Sales, COGS, SG&A Expenses, and tax rates are shown below, **considering growth rates from PNM-Avangrid synergies:**

<b>Assumed Synergies</b>	
Revenue growth 1	0,7%
COGS growth	-0,60%
Revenue growth 2	1,00%
Capex growth	1,60%

*Figure 33: PNM-Avangrid Assumed Synergies Quantification*

Subject Descriptor	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	TV
Inflation	2,7%	3,2%	3,6%	3,5%	3,2%	4,7%	7,4%	4,8%	3,8%	3,4%	3,3%	3,2%	2,6%	1,9%	1,2%	1,0%
Inflation Increase		0,5 p.p.	0,4 p.p.	-0,1 p.p.	-0,3 p.p.	1,5 p.p.	2,7 p.p.	-2,6 p.p.	-1,1 p.p.	-0,3 p.p.	-0,2 p.p.	0,0 p.p.	-0,7 p.p.	-0,7 p.p.	-0,7 p.p.	
COGS/Sales Increase			0,9 p.p.	-0,7 p.p.	0,6 p.p.	5,3 p.p.	9,8 p.p.	-9,2 p.p.	-3,9 p.p.	-1,2 p.p.	-0,5 p.p.	-0,1 p.p.	-2,4 p.p.	-2,4 p.p.	-2,4 p.p.	
Price*Volume	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	TV
Volume (MWh)	13.593.298	14.380.971	14.290.262	14.497.712	15.140.670	15.920.394	16.436.222	16.764.947	16.932.596	17.101.922	17.272.941	17.618.400	17.794.584	17.972.530	18.152.255	
Volume growth		6%	-1%	1%	4%	5%	3,2%	2,0%	1,0%	1,0%	1,0%	2,0%	1,0%	1,0%	1,0%	
AVG Price (\$/MWh)	100	100	101	101	101	112	117	118	119	118	117	117	117	117	115	
Price growth		0%	0%	0%	0%	11%	2,0%	1,0%	1%	-1%	-1%	0%	0%	0%	-1%	
Sales (\$)	1.363	1.445	1.437	1.458	1.523	1.780	1.916	1.974	2.014	2.014	2.014	2.054	2.074	2.095	2.095	

Key Performance Metrics & Drivers	Historical					Forecast									
	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30	TV
Sales growth	6%	-1%	1%	4%	17%	9,4%	4,7%	3,7%	1,7%	1,7%	3,7%	2,7%	2,7%	1,7%	1,0%
COGS / sales	43%	44%	43%	44%	49%	58,0%	48,2%	43,7%	41,8%	40,7%	40,0%	37,0%	33,9%	30,9%	30,3%
SG&A / sales	14%	18%	23%	14%	13%	12,4%	12,4%	13,0%	13,0%	12,7%	12,8%	12,8%	12,8%	12,8%	12,8%
Tax rate	-32%	-4%	38%	-10%	-13%	(11,9%)	(11,9%)	(11,9%)	(11,9%)	(11,9%)	(11,9%)	(11,9%)	(11,9%)	(11,9%)	(11,9%)

Figure 34: PNM's Sales and COGS Drivers

Fixed costs are assumed to remain with the same structure as historically (taking an average of FY17-FY21 period of around 12,9%). COGS are calculated with a strong relation with inflation, increasing proportionally as projected inflation percentage points increase (Source: International Monetary Fund). Sales are projected using a “price times volume” structure, where the volume is expected to grow steadily at an average of 0,2% annually, and electricity prices are projected as different sources indicate.

Working capital figures are projected with a continuous growth related to historical levels.

(\$m)	Historical					Forecast									
	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30	
<b>Net Working Capital</b>															
Inventory	67	72	78	66	65	111	87	78	79	75	75	70	65	59	
Inventory/COGS	-11%	-11%	-12%	-10%	-7%	-10%	-9%	-9%	-9%	-9%	-9%	-9%	-9%	-9%	
Accounts receivable	91	93	86	113	123	129	139	139	139	140	142	144	145	145	
Receivables/Sales	6%	6%	6%	7%	7%	7%	7%	7%	7%	7%	7%	7%	7%	7%	
Accounts payable	(121)	(112)	(103)	(169)	(173)	(229)	(209)	(183)	(178)	(175)	(173)	(162)	(151)	(137)	
Payables/COGS	20%	18%	16%	26%	20%	21%	22%	21%	21%	21%	21%	21%	21%	21%	
Accrued expenses	(62)	(65)	(77)	(68)	(70)	(95)	(95)	(87)	(83)	(77)	(76)	(73)	(69)	(62)	
Accrued expenses/COGS	10%	10%	12%	10%	8%	9%	10%	10%	10%	9%	9%	9%	10%	10%	
Operating working capital	(27)	(13)	(16)	(57)	(54)	(83)	(77)	(53)	(43)	(37)	(32)	(21)	(9)	5	
WC o/ Sales	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.	0%	
(-) Var. WC	38	(14)	3	41	(3)	29	(6)	(25)	(10)	(6)	(5)	(11)	(12)	(14)	
Check	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
Sales	1.445	1.437	1.458	1.523	1.780	1.916	1.974	2.014	2.014	2.014	2.054	2.074	2.095	2.095	
COGS	(617)	(626)	(625)	(663)	(870)	(1.112)	(951)	(879)	(842)	(819)	(821)	(767)	(711)	(648)	

Figure 36: PNM's WC projections

Capex is projected following PNM's strategy backed by Iberdrola's financial muscle (focus on renewables and networks businesses) with realistic growths:

(\$m)	Historical				Forecast									
	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30	
<b>Capex &amp; D&amp;A</b>														
Sales	1.437	1.458	1.523	1.780	1.916	1.974	2.014	2.014	2.014	2.054	2.074	2.095	2.095	
Capex	(481)	(458)	(786)	(1.034)	(797)	(692)	(666)	(797)	(636)	(444)	(760)	(453)	(453)	
Capex o/ Sales	-33%	-31%	-52%	-58%	-42%	-35%	-33%	-40%	-32%	-22%	-37%	-22%	-22%	
D&A	(241)	(268)	(276)	(284)	(321)	(237)	(227)	(289)	(222)	(155)	(269)	(159)	(159)	
D&A o/ Capex	0,5x	0,6x	0,4x	0,3x	0,4x	0,3x	0,3x	0,4x	0,3x	0,4x	0,4x	0,4x	0,4x	

Figure 35: PNM's Capex and D&A Drivers

Historical and projected Free Cash Flows for the DCF valuation method applied to Iberdrola are shown below:

(\$m)	Historical					
	FY16	FY17	FY18	FY19	FY20	FY21
<b>Unlevered Free Cash Flow (UFCF)</b>						
EBIT	278	315	236	144	285	308
Taxes	(63)	(73)	(5)	25	(21)	(33)
NOPAT	215	242	231	170	265	276
Depreciation	209	232	241	268	276	284
Provisions	-	-	-	-	-	-
Impairments	-	-	-	-	-	-
Net Capex	(600)	(404)	(481)	(458)	(786)	(1.034)
Change in working capital	(4)	38	(14)	3	42	(3)
Inventory	(6)	7	(5)	(6)	12	1
Accounts receivable	12	(4)	(2)	7	(28)	(10)
Accounts payable	(14)	35	(9)	(9)	66	3
Accrued expenses	4	1	3	12	(9)	2
Deferred revenue	-	-	-	-	-	-
Other current assets-liab.	(37)	563	8	142	(57)	76
(-) Change in deferred taxes	62	(410)	55	10	73	32
<b>Unlevered free cash flow</b>	<b>(155)</b>	<b>261</b>	<b>41</b>	<b>134</b>	<b>(189)</b>	<b>(369)</b>

Figure 37: PNM's Historical Unlevered Free Cash Flows

(\$m)	Forecast								
	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30
<b>Unlevered Free Cash Flow (UFCF)</b>									
EBIT	174	485	608	601	716	834	820	1.033	1.128
Taxes	(6)	(44)	(57)	(56)	(70)	(84)	(82)	(107)	(118)
NOPAT	168	441	551	544	646	749	738	925	1.010
Depreciation	321	237	227	289	222	155	269	159	159
Provisions	-	-	-	-	-	-	-	-	-
Impairments	-	-	-	-	-	-	-	-	-
Net Capex	(797)	(692)	(666)	(797)	(636)	(444)	(760)	(453)	(453)
Change in working capital	29	(6)	(25)	(10)	(6)	(5)	(11)	(12)	(14)
Inventory	(46)	24	9	(1)	4	(0)	4	5	6
Accounts receivable	(6)	(10)	(0)	0	(1)	(2)	(2)	(2)	0
Accounts payable	57	(20)	(26)	(5)	(3)	(1)	(11)	(12)	(14)
Accrued expenses	25	(0)	(7)	(4)	(6)	(1)	(3)	(4)	(6)
Deferred revenue	-	-	-	-	-	-	-	-	-
Other current assets-liab.	(53)	12	15	(8)	2	(2)	(0)	(1)	1
(-) Change in deferred taxes	(19)	(25)	(40)	22	10	9	2	(9)	(4)
<b>Unlevered free cash flow</b>	<b>(350)</b>	<b>(33)</b>	<b>61</b>	<b>40</b>	<b>237</b>	<b>463</b>	<b>236</b>	<b>610</b>	<b>700</b>

Figure 38: Iberdrola's Forecasted Unlevered Free Cash Flows

### 3.2.6 Terminal/Continuing Value

Terminal value (TV) in this case is the value of the free cash flows to firm beyond the forecasted period when future cash flows can be estimated, i.e., the value at the end of the forecasted period of projecting the FCF to the infinite at a constant growth rate. Thus, the terminal value assumes a business will grow at a set growth rate forever after the forecast period.

The two most common methods for calculating terminal value are perpetual growth (Gordon Growth Model) and exit multiple. The first one assumes that a business will generate cash flows at a constant rate forever, while the second one assumes that a business will be sold at a certain multiple.

### 3..2.6.1 Perpetual growth method (Gordon Growth Model)

$$TV = \frac{FCFF_t \times (1 + g)}{WACC - g}$$

Where:

FCFF<sub>t</sub> = free cash flow to firm for the last forecast period (t)

g = terminal growth rate (constant)

Sensibility tables and valuation made using this TV method are shown below:

(\$m)	FY21	Forecast								
		FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30
(+) Terminal cash flow (01% terminal growth)										13.577
Total cash flow – perpetuity growth meth	-	(350)	(33)	61	40	237	463	236	610	14.277
DCF – perpetuity growth method	9.059									

Enterprise Value				Equity Value							
Terminal Perpetuity Growth Rate				Terminal Perpetuity Growth Rate							
0,5%				1,0%				1,5%			
WACC	5,2%	10.731	11.910	13.406	6.631	7.810	9.307				
	6,2%	8.331	9.059	9.942	4.232	4.960	5.842				
	7,2%	6.674	7.156	7.722	2.574	3.056	3.623				

Implied Terminal EBITDA Multiple				Value Per Share							
Terminal Perpetuity Growth Rate				Terminal Perpetuity Growth Rate							
0,5%				1,0%				1,5%			
WACC	5,2%	11,6x	13,1x	14,9x	77	91	108				
	6,2%	9,6x	10,5x	11,7x	49	58	68				
	7,2%	8,1x	8,8x	9,7x	30	36	42				

Figure 39: PNM's DCF Valuation with Growth in Perpetuity method

### 3..2.6.2 Exit multiple method

$$TV = EBITDA_t \times \left( \frac{EV}{EBITDA} \right)_t$$

Where:

- $EBITDA_t$  is the EBITDA for the last forecast period (t)
- $\left( \frac{EV}{EBITDA} \right)_t$  is the EV/EBITDA exit multiple

The calculation of the exit multiple is shown below (it is needed to calculate the forward EV and divide it by the last forecasted EBITDA):

$$\text{Forward EV} = \text{Current EV} * (1 + \text{WACC})^n / (1 + \text{FCF yield})^n$$

(\$m)	2021		
MC	4.113		
Debt	4.101		
Preferr.	-		
Minority	56		
Cash & Eq	(1)		
Equity Inv.	(553)	FCF Yield	2,0%
<b>Current EV</b>	<b>7.716</b>	<b>Forward EV</b>	<b>11.050</b>

Then, the right exit multiple is (where forecasted EBITDA is \$1.191m for F29):

$$\left( \frac{EV}{EBITDA} \right)_t = \frac{11.050}{1.191} = 9,3x$$

Sensibility tables and valuation made using this TV method are shown below:

(\$m)	FY21	Forecast								
		FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30
(+ ) Terminal cash flow (09x terminal multiple)										11.939
Total cash flow – EBITDA multiple method	-	(350)	(33)	61	40	237	463	236	610	12.639
DCF – EBITDA multiple method	8.106									



		<b>Enterprise Value</b>			<b>Equity Value</b>		
		Terminal EBITDA Multiple			Terminal EBITDA Multiple		
		8,3x	9,3x	10,3x	8,3x	9,3x	10,3x
WACC	5,2%	8.011	8.826	9.642	3.912	4.727	5.542
	6,2%	7.358	8.106	8.855	3.258	4.007	4.756
	7,2%	6.762	7.450	8.138	2.662	3.351	4.039
		<b>Implied Perpetuity Growth Rate</b>			<b>Value Per Share</b>		
		Terminal EBITDA Multiple			Terminal EBITDA Multiple		
		8,3x	9,3x	10,3x	8,3x	9,3x	10,3x
WACC	5,2%	-1%	-1%	0%	45,5	55,0	64,5
	6,2%	0%	0%	1%	37,9	46,6	55,3
	7,2%	1%	1%	2%	31,0	39,0	47,0

*Figure 40: PNM's DCF Valuation with Growth in Perpetuity method*

### 2.3.3. MULTIPLES

Valuation using multiples, or “relative valuation”, is a process that consists of: 1) identifying comparable companies (peers or comps) and obtaining market values for these assets, 2) converting these market values into standardized values relative to a key statistic, since the absolute prices cannot be compared. This process of standardizing creates valuation multiples (EV/EBITDA, P/E, P/Revenue), and 3) applying the valuation multiple to the key statistic of the asset being valued, controlling for any differences between asset and the peer group that might affect the multiple.

Peer groups refer to companies that are in the same industry or sector. These are competitors that are roughly the same size. Qualities among members for corporate peer groups include size, industry, sector, business lines, and/or financial position.

PNM's relative valuation is shown below:

### Comparable Companies Analysis

Company Name	Market Cap.	Current Enterprise Value	Revenue	Long Term Growth (*)	EBITDA	EBITDA Margin Hist. Avg	Enterprise Value to EBITDA	Iberdrola's EV from Comps Analysis
(\$m)	Jul. 2022	Jul. 2022	FY21	FY18 - FY21	FY2021	FY18 - FY21	FY22	Jul-22
PNM Resources Inc	4.113	7.716	1.780	5%	592	34%	13,0x	n.m.
Xcel Energy Inc	41.549	65.277	13.337	7%	4.460	33%	14,6x	n.m
PG&E Corp	29.905	78.221	20.642	n.a	6.061	29%	12,9x	n.m
NorthWestern Corp	3.139	5.665	1.372	0%	463	34%	12,2x	n.m
Edison International	26.986	60.045	14.905	n.a	5.325	36%	11,3x	n.m
American Electric Power Company Inc	53.315	90.378	16.425	6%	6.249	38%	14,5x	n.m
Low	3.139	5.665	1.372	0%	463x	29%	11x	6.679
Mean	30.979	59.917	13.336	4%	4.512x	34%	13x	7.761
Median	29.905	65.277	14.905	6%	5.325x	34%	13x	7.644
High	53.315	90.378	20.642	7%	6.249x	38%	15x	8.669

(\*) Long Term Growth - Mean by Refinitiv

Figure 41: PNM's Comparable Companies Analysis

From this valuation, PNM Resources is the second smaller company in terms of sales, EBITDA, current EV, and Market Capitalization. However, its long-term revenue growth and EBITDA margin are approximately the averages of the comparable set, which indicates that the company fluctuates at the same pace as its competitors, and it is also as efficient as them. The EV to EBITDA multiple shows that PNM is in the middle of a symmetric distribution where almost all the companies are valued at around the same multiple (between 11x and 15x) with low differences among comparable companies.

### 2.3.4. VALUATION RESULTS

From the results obtained with Comparable Companies method, DCF using Exit Multiple method, and DCF using Growth in Perpetuity method; Iberdrola's intrinsic Enterprise Value is estimated to be **\$8.112m**.

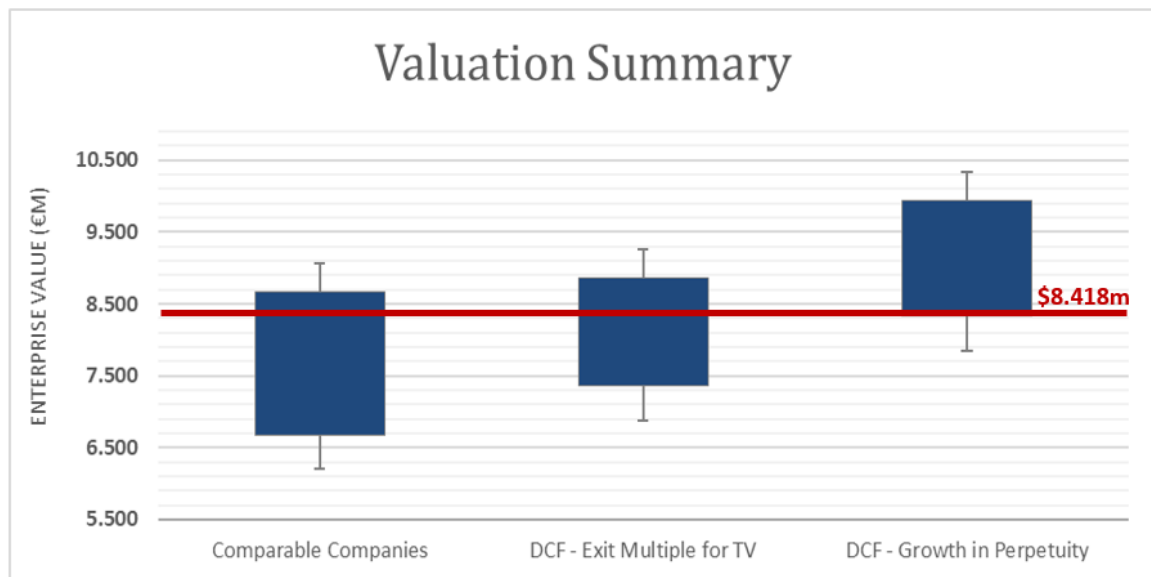


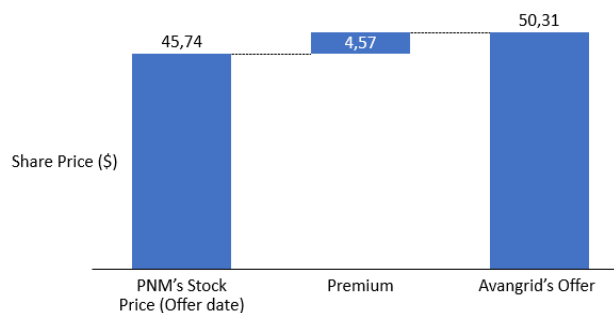
Figure 42: PNM's Valuation Summary



## Chapter 3. *RESULTS & CONCLUSIONS*

### 3.1. DEAL CONSIDERATIONS & SOURCES OF FUNDS

Avangrid plans to acquire PNM in an all-cash deal, at a price of \$50,30/share and total consideration of ~\$4,3b. In 2019, Avangrid argues that this deal supposes a 10% premium to PNM's trading price of \$45.74/share and a 19.3% premium to PNM's 30-day volume weighted average price.



*Figure 43: Avangrid's Premium Paid per Share*

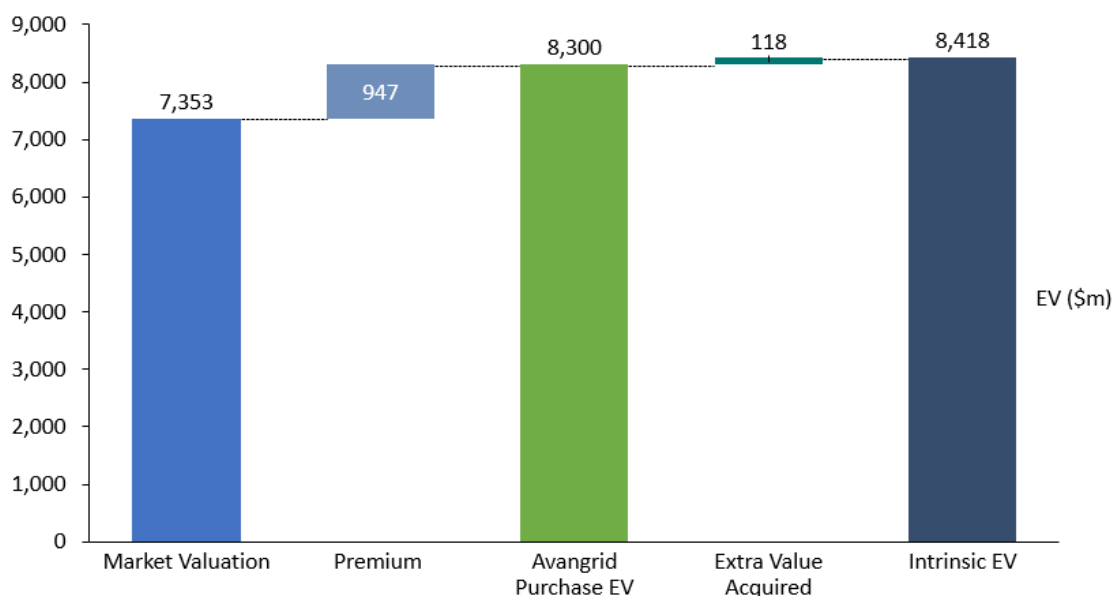
Further in this project, this Avangrid's valuation will be assessed and compared to the intrinsic value of PNM + Avangrid Synergies and to the market price of PNM to conclude if the deal makes sense or not.

Iberdrola will provide a funds commitment letter to Avangrid to finance the transaction (Current Iberdrola Group's liquidity position of EUR ~14 Bn will not be affected).

### 3.2. RESULTS

Once all valuations are obtained, it is assessed if the deal makes sense or not for Avangrid. The way that this conclusion is obtained is by comparing the actual EV related to the actual price paid by Avangrid in the acquisition with the intrinsic valuation, and the market valuation, both shown in the previous chapter.

In the following figure all results obtained are exposed:



*Figure 44: Results' Bridge Analysis*

### 3.3. CONCLUSIONS

It can be concluded that the acquisition makes sense in theory for Avangrid after this project's intrinsic valuation. The premium paid to PNM's shareholders in terms of EV is 12,8% while the value acquired for free in the deal amounts \$118m.

However, besides the deal adds these \$118m of EV to Avangrid, that amount supposes a 1,42% of the purchase EV, which is a low percentage. This, coupled with the subjective

characteristic of the DCF valuation method, gives a very thin margin to the deal for being considered successful.

## **Chapter 4. *CHAPTER 4. ESG INVESTMENT***

### ***CRITERIA AND SUSTAINABLE DEVELOPMENT***

#### ***GOALS (SDG)***

As a result of the continuing dialogue with its Stakeholders, and aware of the unquestionable economic, social and environmental impact of all its activities, Iberdrola (thus Avangrid) has a sustainable development strategy aligned with the group's implementation of a business plan focused on the sustainable creation of value, primarily based on its Purpose and Values, and respect for human rights.

Thus, it promotes initiatives, such as this transaction that aims to create a combined company to boost renewable energies in the United States, that contribute to bringing about a more just, equal and healthy society, and, in particular, to achieving the SDGs, notably those relating to: Affordable and clean energy (SDG 7) and Climate action (SDG 13), through specific lines of action focused on universal access (SDG 7.1), increasing renewable energy (SDG 7.2) and developing measures to improve energy efficiency (SDG 7.3) using tools such as fostering innovation (SDG 9), education (SDG 4), protection of biodiversity (SDG 15), gender equality (SDG 5) in particular, and reduced inequalities (SDG 10) in general, which essentially entails protecting disadvantaged groups. Iberdrola defends the role played by the SDGs and Agenda 2030 as a global social compact, because global problems such as climate change and the pandemic call for global solutions and agreements. Iberdrola has linked its business and sustainability strategy to the Sustainable Development Goals (SDGs) since they were set in 2015, and in 2018 it approved an update of its Corporate Governance System, which was mainly intended to formalise the Iberdrola group's commitment to the



SDGs, underscoring the group's contribution to achieving them with the social dividend generated through its business activity.

In December 2020 Iberdrola reformulated its governance and sustainability system, structuring it around ESG standards aligned with its sustainable development strategy and its social dividend, which cemented the company's position at the forefront of best international corporate governance practices. This was a key element for overcoming the differences resulting from COVID-19 in 2020 and 2021. The recovery from this crisis was based on strengthening institutions' social and sustainability parameters.

## **4.1. CLIMATE ACTION**

Iberdrola was a pioneer in the inclusion within its former Corporate Governance System of the fight against climate change as a priority. In 2009 it approved the first policy that addressed the fight against climate change. The current Climate Action Policy establishes the framework for Iberdrola's strategy and business model, which is in line with the Paris Agreement and the 2030 Agenda, in the fight against climate change. Through this policy, Iberdrola is committed to continuing assuming a leadership position (directly and by establishing partnerships), promoting awareness (impacts, challenges and benefits of its achievement), and contributing to a carbon-neutral and sustainable future.

Iberdrola's principles of conduct include implementation of the recommendations of the Task Force on Climate-related Financial Disclosure (TCFD) and of other leading organisations for identifying and reporting long-term risks relating to climate change. Along these lines, Iberdrola was one of the first companies to publicly commit to implementing the recommendations of the Task Force on Climate-related Financial Disclosures. For this purpose, the company created an internal multidisciplinary working group in 2017 to coordinate all the work performed in this area.

### IBERDROLA GROUP'S CLIMATE-RELATED OBJECTIVES



Figure 45: Iberdrola's Group Climate Objectives

## 4.2. GOVERNANCE & SUSTAINABILITY

The company has a Governance and Sustainability System, which evolved from the former Corporate Governance System, and which is structured around three pillars: environmental, social and corporate governance.

## STRUCTURE OF THE GOVERNANCE AND SUSTAINABILITY SYSTEM

The Governance and Sustainability System is the Company's **internal system of rules**. It configures Iberdrola as an **integral company** that enriches its purely corporate dimension with plural (economic, social, environmental and governance) business activities. Always at the forefront of international best practices, it is structured into **five books**:

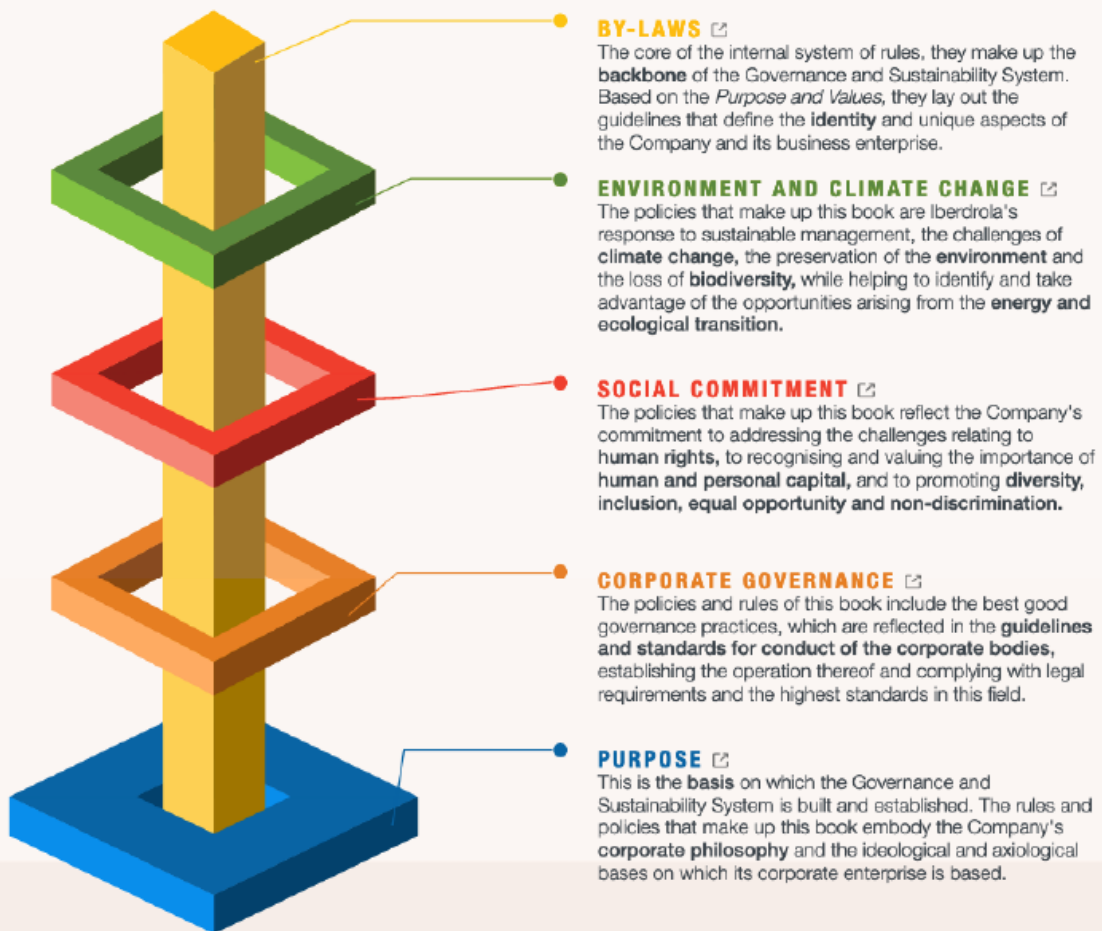


Figure 46: Iberdrola's Group Governance System



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## APENDIX: PNM'S HISTORICAL AND PROJECTED FINANCIAL STATEMENTS (+ AVANGRID SYNERGIES)

Income Statement						
(\$m)	Historical					
	FY16	FY17	FY18	FY19	FY20	FY21
Revenue	1.363	1.445	1.437	1.458	1.523	1.780
Revenue growth rate		6%	-1%	1%	4%	17%
COGS	(593)	(617)	(626)	(625)	(663)	(870)
Gross profit	770	828	811	832	860	910
SG&A	(207)	(205)	(254)	(340)	(217)	(232)
Taxes Other than income Taxes	(76)	(77)	(80)	(80)	(82)	(86)
EBITDA	487	547	477	412	561	592
EBITDA Margin	36%	38%	33%	28%	37%	33%
D&A	(209)	(232)	(241)	(268)	(276)	(284)
Impairment losses, trade and other receivables (Non-cash)	-	-	-	-	-	-
Provisions	-	-	-	-	-	-
EBIT	278	315	236	144	285	308
Net Financial Income/Expense	(106)	(112)	(112)	(107)	(100)	(82)
Other (income) / expense	24	23	(15)	30	23	19
EBT	195	226	109	67	208	245
Tax o/ EBT	32%	32%	4%	-38%	10%	13%
Income tax	(63)	(73)	(5)	25	(21)	(33)
GAAP net income	132	153	104	92	188	212
Net income attributable to noncontrolling interests	(15)	(15)	(15)	(14)	(14)	(16)
NCI Net Income o/ GAAP Net Income	-11%	-10%	-15%	-15%	-7%	-7%
NET PROFIT/(LOSS) FOR THE YEAR FROM DISCONTINUED OPER	-	(58)	(3)	-	-	-
Preferred dividends	-	-	-	-	-	-
GAAP net income available to common	117	80	86	78	173	196

Figure 47: PNM's Historical Income Statement

### Income Statement

(Sm)	Forecast								
	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30
<b>Revenue</b>	<b>1.947</b>	<b>2.039</b>	<b>2.114</b>	<b>2.150</b>	<b>2.186</b>	<b>2.267</b>	<b>2.328</b>	<b>2.391</b>	<b>2.432</b>
<i>Revenue growth rate</i>	9,4%	4,7%	3,7%	1,7%	1,7%	3,7%	2,7%	2,7%	1,7%
<b>COGS</b>	<b>(1.130)</b>	<b>(982)</b>	<b>(923)</b>	<b>(899)</b>	<b>(889)</b>	<b>(906)</b>	<b>(861)</b>	<b>(812)</b>	<b>(752)</b>
<b>Gross profit</b>	<b>817</b>	<b>1.056</b>	<b>1.191</b>	<b>1.251</b>	<b>1.297</b>	<b>1.361</b>	<b>1.468</b>	<b>1.580</b>	<b>1.680</b>
<b>SG&amp;A</b>	<b>(242)</b>	<b>(253)</b>	<b>(275)</b>	<b>(280)</b>	<b>(278)</b>	<b>(290)</b>	<b>(298)</b>	<b>(307)</b>	<b>(311)</b>
<b>Taxes Other than income Taxes</b>	<b>(80,1)</b>	<b>(80,7)</b>	<b>(81,3)</b>	<b>(81,6)</b>	<b>(81,9)</b>	<b>(81,9)</b>	<b>(81,2)</b>	<b>(81,4)</b>	<b>(81,6)</b>
<b>EBITDA</b>	<b>495</b>	<b>723</b>	<b>835</b>	<b>889</b>	<b>937</b>	<b>989</b>	<b>1.089</b>	<b>1.191</b>	<b>1.287</b>
<i>EBITDA Margin</i>	25,4%	35,4%	39,5%	41,4%	42,9%	43,6%	46,8%	49,8%	52,9%
<b>D&amp;A</b>	<b>(321)</b>	<b>(237)</b>	<b>(227)</b>	<b>(289)</b>	<b>(222)</b>	<b>(155)</b>	<b>(269)</b>	<b>(159)</b>	<b>(159)</b>
Impairment losses, trade and other receivables (Non-cash)	-	-	-	-	-	-	-	-	-
Provisions	-	-	-	-	-	-	-	-	-
<b>EBIT</b>	<b>174</b>	<b>485</b>	<b>608</b>	<b>601</b>	<b>716</b>	<b>834</b>	<b>820</b>	<b>1.033</b>	<b>1.128</b>
<b>Net Financial Income/Expense</b>	<b>(124,0)</b>	<b>(115,6)</b>	<b>(126,6)</b>	<b>(125,9)</b>	<b>(131,0)</b>	<b>(124,8)</b>	<b>(128,4)</b>	<b>(131,4)</b>	<b>(134,8)</b>
Other (income) / expense	-	-	-	-	-	-	-	-	-
<b>EBT</b>	<b>50</b>	<b>370</b>	<b>482</b>	<b>475</b>	<b>585</b>	<b>709</b>	<b>691</b>	<b>901</b>	<b>993</b>
<i>Tax of EBT</i>	-12%	-12%	-12%	-12%	-12%	-12%	-12%	-12%	-12%
<b>Income tax</b>	<b>(6)</b>	<b>(44)</b>	<b>(57)</b>	<b>(56)</b>	<b>(70)</b>	<b>(84)</b>	<b>(82)</b>	<b>(107)</b>	<b>(118)</b>
<b>GAAP net income</b>	<b>44</b>	<b>326</b>	<b>424</b>	<b>418</b>	<b>515</b>	<b>624</b>	<b>609</b>	<b>794</b>	<b>875</b>
Net income attributable to noncontrolling interests	(3)	(24)	(31)	(31)	(38)	(46)	(45)	(58)	(64)
<i>NCI Net Income of GAAP Net Income</i>	-7%	-7%	-7%	-7%	-7%	-7%	-7%	-7%	-7%
<b>NET PROFIT/(LOSS) FOR THE YEAR FROM DISCONTINUED OPERATIONS</b>	<b>(0,7)</b>	<b>(0,2)</b>	<b>(0,2)</b>	<b>(0,3)</b>	<b>(0,4)</b>	<b>(0,3)</b>	<b>(0,3)</b>	<b>(0,3)</b>	<b>(0,3)</b>
Preferred dividends	-	-	-	-	-	-	-	-	-
<b>GAAP net income available to common</b>	<b>46</b>	<b>349</b>	<b>455</b>	<b>448</b>	<b>552</b>	<b>670</b>	<b>653</b>	<b>852</b>	<b>939</b>

Figure 48: PNM's Forecasted Income Statement

### Balance Sheet

(\$m)	FY15	FY16	FY17	FY18	FY19	FY20	FY21
<b>Assets</b>							
Cash and equivalents	46	5	4	2	4	48	1
Accounts receivable	99	87	91	93	86	113	123
Inventory	67	73	67	72	78	66	65
Deferred tax asset, current	-	-	-	-	-	-	-
Other current assets	173	214	134	136	126	150	135
<b>Total current assets</b>	<b>386</b>	<b>378</b>	<b>295</b>	<b>303</b>	<b>294</b>	<b>377</b>	<b>325</b>
PP&E, net	4.801	5.192	5.363	5.603	5.793	6.304	7.054
Goodwill	278	278	278	278	278	278	278
Other intangible assets	-	-	-	-	-	-	-
Equity investments	262	274	344	358	454	531	553
Right-of-use assets	-	-	-	-	131	105	80
Deferred tax asset	74	75	92	90	106	101	139
Other assets	209	274	274	234	242	243	239
<b>Total non-current assets</b>	<b>5.624</b>	<b>6.093</b>	<b>6.352</b>	<b>6.563</b>	<b>7.005</b>	<b>7.562</b>	<b>8.342</b>
<b>Total assets</b>	<b>6.009</b>	<b>6.471</b>	<b>6.646</b>	<b>6.866</b>	<b>7.299</b>	<b>7.940</b>	<b>8.667</b>
<b>Liabilities &amp; Shareholders' Equity</b>							
Accounts payable	100	87	121	112	103	169	173
Notes payable	-	-	-	-	-	-	-
Accrued expenses	58	62	62	65	77	68	70
Client deposits	-	-	-	-	-	-	-
Income taxes payable	-	-	-	-	-	-	-
Deferred revenue	-	-	-	-	-	-	-
Other current liabilities	105	94	88	98	111	131	174
Current portion of financial long-term debt	378	563	564	237	677	610	248
<b>Total current liabilities</b>	<b>641</b>	<b>805</b>	<b>836</b>	<b>513</b>	<b>968</b>	<b>978</b>	<b>664</b>
Total debt	2.101	2.260	2.316	2.838	2.703	2.975	3.853
Net deferred tax liability	877	941	547	601	626	695	765
Other liabilities	652	709	1.174	1.151	1.249	1.173	1.151
<b>Total non-current liabilities</b>	<b>3.631</b>	<b>3.910</b>	<b>4.038</b>	<b>4.589</b>	<b>4.578</b>	<b>4.842</b>	<b>5.768</b>
<b>Total liabilities</b>	<b>4.272</b>	<b>4.715</b>	<b>4.873</b>	<b>5.102</b>	<b>5.546</b>	<b>5.820</b>	<b>6.432</b>
Noncontrolling interests	71	69	66	64	63	59	56
Common stock, par value	1.167	1.164	1.158	1.153	1.151	1.430	1.429
Additional paid-in capital (APIC)	-	-	-	-	-	-	-
Treasury stock	-	-	-	-	-	-	-
Accum. & other comp. income / (loss)	571	616	646	657	639	710	822
Other & Retained Earnings	(72)	(92)	(97)	(111)	(99)	(79)	(72)
<b>Total Equity</b>	<b>1.738</b>	<b>1.756</b>	<b>1.773</b>	<b>1.764</b>	<b>1.753</b>	<b>2.120</b>	<b>2.235</b>
<b>Total liabilities &amp; shareholders' equity</b>	<b>6.009</b>	<b>6.471</b>	<b>6.646</b>	<b>6.866</b>	<b>7.299</b>	<b>7.940</b>	<b>8.667</b>

Figure 49: PNM's Historical Balance Sheet



### Balance Sheet

(\$m)	FY15	Forecast								
		FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30
<b>Assets</b>										
Cash and equivalents	46	93	212	346	414	693	874	1.156	1.809	2.577
Accounts receivable	99	129	139	139	139	140	142	144	145	145
Inventory	67	111	87	78	79	75	75	70	65	59
Deferred tax asset, current	-	-	-	-	-	-	-	-	-	-
Other current assets	173	153	150	140	141	142	144	144	145	144
<b>Total current assets</b>	<b>386</b>	<b>486</b>	<b>587</b>	<b>704</b>	<b>773</b>	<b>1.050</b>	<b>1.235</b>	<b>1.514</b>	<b>2.164</b>	<b>2.925</b>
PP&E, net	4.801	7.529	7.984	8.423	8.932	9.347	9.635	10.126	10.420	10.714
Goodwill	278	278	278	278	278	278	278	278	278	278
Other intangible assets	-	-	-	-	-	-	-	-	-	-
Equity investments	262	513	532	532	526	530	529	528	529	529
Right-of-use assets	-	105	97	94	99	96	96	97	97	97
Deferred tax asset	74	115	118	124	119	121	121	121	121	121
Other assets	209	241	241	240	241	241	241	241	241	241
<b>Total non-current assets</b>	<b>5.624</b>	<b>8.782</b>	<b>9.251</b>	<b>9.693</b>	<b>10.195</b>	<b>10.613</b>	<b>10.901</b>	<b>11.392</b>	<b>11.686</b>	<b>11.979</b>
<b>Total assets</b>	<b>6.009</b>	<b>9.269</b>	<b>9.838</b>	<b>10.396</b>	<b>10.968</b>	<b>11.662</b>	<b>12.136</b>	<b>12.906</b>	<b>13.851</b>	<b>14.905</b>
<b>Liabilities &amp; Shareholders' Equity</b>										
Accounts payable	100	229	209	183	178	175	173	162	151	137
Accrued expenses	58	95	95	87	83	77	76	73	69	62
Other current liabilities	105	138	147	153	146	149	149	148	149	149
Current portion of financial long-term debt	378	272	286	295	302	309	297	304	312	320
<b>Total current liabilities</b>	<b>641</b>	<b>735</b>	<b>737</b>	<b>718</b>	<b>709</b>	<b>710</b>	<b>696</b>	<b>688</b>	<b>680</b>	<b>668</b>
Total debt	2.101	4.508	4.733	4.875	4.996	5.121	4.916	5.039	5.165	5.294
Net deferred tax liability	877	722	699	665	682	693	703	704	695	692
Other liabilities	652	1.179	1.180	1.186	1.174	1.174	1.179	1.179	1.178	1.177
<b>Total non-current liabilities</b>	<b>3.631</b>	<b>7.554</b>	<b>7.784</b>	<b>7.892</b>	<b>8.009</b>	<b>8.157</b>	<b>7.940</b>	<b>8.062</b>	<b>8.180</b>	<b>8.299</b>
<b>Total liabilities</b>	<b>4.272</b>	<b>7.144</b>	<b>7.350</b>	<b>7.444</b>	<b>7.561</b>	<b>7.698</b>	<b>7.494</b>	<b>7.609</b>	<b>7.719</b>	<b>7.830</b>
Noncontrolling interests	71	56	56	56	56	56	56	56	56	56
Common stock, par value	1.167	1.429	1.429	1.429	1.429	1.429	1.429	1.429	1.429	1.429
Accum. & other comp. income / (loss)	571	666	679	688	694	700	708	708	692	696
Other & Retained Earnings	(72)	(26)	324	779	1.227	1.780	2.450	3.103	3.955	4.894
<b>Total Equity</b>	<b>1.738</b>	<b>2.125</b>	<b>2.488</b>	<b>2.952</b>	<b>3.407</b>	<b>3.964</b>	<b>4.643</b>	<b>5.296</b>	<b>6.132</b>	<b>7.074</b>
<b>Total liabilities &amp; shareholders' equity</b>	<b>6.009</b>	<b>9.269</b>	<b>9.838</b>	<b>10.396</b>	<b>10.968</b>	<b>11.662</b>	<b>12.136</b>	<b>12.906</b>	<b>13.851</b>	<b>14.905</b>

Figure 50: PNM's Forecasted Balance Sheet