

Sector View

Integrated Utilities

	1 M	3 M	6 M	31/12/15
Utilities	0.0%	-2.6%	1.5%	-5.7%
DJ Stoxx 600	2.6%	-4.6%	-1.8%	-7.0%

*Stoxx Sector Indices

Companies covered

E.ON	BUY	EUR10,2
Last Price	EUR8,238	Market Cap. EUR16,484m
EDF	BUY	EUR14,5
Last Price	EUR10,415	Market Cap. EUR19,998m
ENGIE	BUY	EUR17
Last Price	EUR13,7	Market Cap. EUR33,363m
RWE	NEUTRAL	EUR9,8
Last Price	EUR10,835	Market Cap. EUR6,559m



Gas is back?

As part of the *BG Utilities Club*, we hosted a breakfast meeting yesterday on the gas and LNG market with an expert working with major energy firms. The event was useful to summarise past and future trends in gas volumes and prices in such a difficult environment. We understand prices will remain under pressure due to a plethora of offer (LNG notably), to the detriment of E&P businesses, but to the benefit of power generation from CCGT. In our universe, both Engie and E.ON seem the best exposed to the stability/recovery in the gas market, while EDF and RWE are the least exposed.

ANALYSIS

- **A quick look at the worldwide gas market:** For decades, the worldwide gas market was piloted by major gas producers (Russia, Norway, Algeria...), which settled oil contract prices through long term contracts. This market was progressively disrupted by the arrival of new producing countries, such as Indonesia, Qatar, Iran and the US for instance, which progressively modified the market structure to the profit of shorter term contracts, and to the detriment of oil indexed contracts. The gas market is now **more liquid**, with a strong **convergence between different market prices** (price range of USD4/6MMBtu) benefiting final users. Following massive price declines (divided by 2 in 3 years), due to lower gas demand and the oil price decline (still 10-20% oil indexed contracts), gas power generation assets are not in the money like coal assets, to the profit of integrated utilities exposed to this technology (Engie, E.ON, Gas Natural...)
- **Main elements/figures to retain:** 1/ gas demand over the past **15 years** was mainly driven by power generation needs, and not so much by private households and industrial needs. 2/ LNG represents roughly **10-12%** of the worldwide gas demand and this rate is set to increase over coming years with new capacities opening in the pipe in the US and Australia. 2/TTF gas prices are down **50%** since 2012 to **EUR13.6/MWh**, while coal over the same period is down **60%** (in USD, and down 51% in EUR). 3/Marginal costs between both coal and gas still favour of coal, although the recent gas price decline is now putting certain CCGT assets back in the money. **A higher carbon tax combined with higher coal prices could further return gas power generation assets to the grid.**
- **Our view:** We remain cautious on the gas market outlook and see no short term recovery for prices, as oversupply will remain high with the commissioning of new LNG capacities from the US and Australia. Gas demand is set to stem mainly from emerging markets, but also from Europe with the progressive stoppage of coal power assets. Our current view on the European integrated subsector notably reflects our view on the gas market, as **we continue to favour Engie over EDF and E.ON over RWE**. We see stronger upside for both the short and longer terms for utilities exposed to CCGT assets rather than coal assets. Note nevertheless that, most of the earnings growth potential for these utilities could only come from higher volumes, and prices stability, not from prices recovery.

VALUATION

- We continue to prefer Engie over EDF and E.ON over RWE

NEXT CATALYSTS

- 7th April 2016: Utilities & Renewables Conference at Bryan Garnier

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