Sector View

Integrated Utilities

Gas is back?

	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*

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 plethoric 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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Analyst :
Xavier Caroen
33(0) 1.56.68.75.18
xcaroen@bryangarnier.com

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Distribution of stock ratings

BUY ratings 64,4%　　NEUTRAL ratings 28,1%　　SELL ratings 7,4%

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London	Paris	New York	Geneva	New Delhi
Beaufort House	26 Avenue des Champs Elysées	750 Lexington Avenue	rue de Grenus 7	The Imperial Hotel
15 St. Botolph Street	75008 Paris	New York, NY 10022	CP 2113	Janpath
London EC3A 7BB	Tel: +33 (0) 1 56 68 75 00	Tel: +1 (0) 212 337 7000	Genève 1, CH 1211	New Delhi 110 001
Tel: +44 (0) 207 332 2500	Fax: +33 (0) 1 56 68 75 01	Fax: +1 (0) 212 337 7002	Tel +4122 731 3263	Tel +91 11 4132 6062
Fax: +44 (0) 207 332 2559	Regulated by the	FINRA and SIPC member	Fax+4122731 3243	+91 98 1111 5119
Authorised and regulated by the	Financial Conduct Authority (FCA) and		Regulated by the	Fax +91 11 2621 9062
Financial Conduct Authority	the Autorité de Contrôle prudential et de		FINMA	
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