

Sector View

Integrated Utilities

	1 M	3 M	6 M	31/12/15
Utilities	3.4%	0.8%	-6.5%	-2.8%
DJ Stoxx 600	3.6%	2.4%	-7.6%	-5.1%

*Stoxx Sector Indices

Companies covered

E.ON	BUY	EUR10
Last Price	EUR9,063	Market Cap. EUR18,135m
EDF	BUY	EUR13,5
Last Price	EUR11,545	Market Cap. EUR22,168m
ENGIE	BUY	EUR16,5
Last Price	EUR14,3	Market Cap. EUR34,825m
RWE	NEUTRAL	EUR9,5
Last Price	EUR12,395	Market Cap. EUR7,491m



Carbon floor price to the rescue?

The implementation of a carbon price floor mechanism in France by 2017 now seems possible with the French President confirming comments made earlier by the Energy Minister. If confirmed, we estimate French power prices could increase by around EUR17/MWh to EUR45/MWh closer to the 2013-14 level and to the benefit of EDF and Engie. We see strong upside for EDF and Engie if confirmed. Positive.

ANALYSIS

- What's in the news?** Earlier this week, France's President Hollande stated at a conference that France will adopt a **unilateral carbon price floor**, and repeated this in a tweet from the French Presidency official Twitter account. This statement confirms the comments made by Energy minister Ségolène Royal a few days ago when announcing that a French carbon floor could come into force as early as January 2017. Back then, Royal indicated that carbon prices needed to reach a figure of around **EUR30/tonne** to promote switching from coal to gas in France. Her comment was accompanied by interesting figures confirming the strong difference in load factors between gas and coal assets in France. Implementing this carbon floor, similar to a move already implemented in the UK (*GBP18/tonne on top of the EU ETS price implies a full carbon price of EUR29-30/tonne*) should push up French power prices (*and potentially Belgian and German power prices*) given that the **short run marginal cost** (SRMC) of both gas and coal generation assets will increase from **EUR20-29/MWh** today to **EUR42-49/MWh**. This increase in SRMC suggests that French power prices could rise up to **EUR45/MWh vs. EUR28-29/MWh**, primarily to the benefit of **EDF**.
- Impact for EDF?** Given that this carbon price floor is only set to be implemented in France implies most of the direct impact will occur in the French power market even if repercussions could be seen in other bordering countries such as Belgium or Germany. EDF's strong exposure to non CO2 emitting technologies (nuclear, hydro and other renewables in France) logically makes it the most positively impacted by such a mechanism. Assuming this **EUR30/tonne carbon price floor is implemented in France** could imply, as mentioned above, a rise in the French power price curve of **EUR15-17/MWh to EUR45/MWh**. Integrating this estimate into our EDF model would imply a near doubling in our restated **EDF 2018e EPS to EUR1.85/share** leading to an implicit **2018e P/E of 6.2x** at the current share price compared with **12.3x** assuming French power prices remain below the **EUR30/MWh** level. We estimate a **EUR1/MWh** increase in French power prices could have a positive impact of around **5-6%** on our restated EPS. **EDF is the most exposed to changes in power prices in our integrated utilities universe**. We also estimate that our FV for EDF could almost double to **EUR25/share** (+80% upside) assuming prices get closer to **EUR45/MWh**.
- Impact for other integrated utilities?** The above sensitivity assumption for EDF is only based on French power generation assets, yet when extrapolating this impact to the average European power price (*currently at EUR30/MWh*) we estimate Engie and E.ON could see their EPS climb by **1.7% and 1.2%** respectively for a EUR1/MWh increase in prices. Assuming **EUR45/MWh** is the new power price to reflect the **EUR30/tonne** carbon price floor, could then imply a double digit EPS increase for Engie and E.ON (*respectively 22% and 18%*), and a mid-single digit increase for RWE (*higher exposure to coal and lignite and more limited exposure to nuclear*). Based on this estimate this could imply a potential FV impact of +EUR3 for Engie, +EUR1.9 for E.ON and only +EUR0.5 for RWE.
- Conclusion:** A mechanism of this type would clearly be a strong earnings growth driver for the sector, yet given that the decision to implement it or not remains in the hands of politicians it is hard for us to put a probability in it. In our models we continue to assume power prices will remain below EUR30/MWh on average, yet favour stocks with low exposure to coal and high exposure to renewables.

VALUATION

- At the current share price, the SX6P index is trading at 18x and offers a 4.8% yield.
- We continue to favour Engie and E.ON over EDF and RWE

NEXT CATALYSTS

- 29th April – Engie // Q1-16 earnings
- 10th May – EDF // Q1-16 earnings
- 11th May – E.ON // Q1-16 earnings
- 12th May – RWE // Q1-16 earnings

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