

## Sector View

## Utilities

## TOP PICKS Q2 2016: No strong convictions for the quarter

	1 M	3 M	6 M	31/12/15
Utilities	2.5%	-5.3%	-1.1%	-5.3%
DJ Stoxx 600	1.1%	-7.7%	-2.9%	-7.7%

\*Stoxx Sector Indices

## Companies covered

<b>ALBIOMA</b>		<b>BUY</b>		<b>EUR16</b>
Last Price	EUR13,6	Market Cap.		EUR405m
<b>E.ON</b>		<b>BUY</b>		<b>EUR10</b>
				vs. 10,2
Last Price	EUR8,438	Market Cap.		EUR16,884m
<b>EDF</b>		<b>BUY</b>		<b>EUR13.5</b>
				vs. 14,5
Last Price	EUR9,864	Market Cap.		EUR18,940m
<b>ENGIE</b>		<b>BUY</b>		<b>EUR16.5</b>
				vs. 17
Last Price	EUR13,64	Market Cap.		EUR33,217m
<b>PENNON GROUP</b>		<b>SELL</b>		<b>825p</b>
Last Price	811p	Market Cap.		GBP3,344m
<b>RWE</b>		<b>NEUTRAL</b>		<b>EUR9.5</b>
				vs. 9,8
Last Price	EUR11,375	Market Cap.		EUR6,881m
<b>SUEZ</b>		<b>BUY</b>		<b>EUR18.5</b>
				vs. 19
Last Price	EUR16,12	Market Cap.		EUR8,747m
<b>VEOLIA ENVIRONNEMENT</b>		<b>NEUTRAL</b>		<b>EUR22</b>
				vs. 22,5
Last Price	EUR21,17	Market Cap.		EUR11,926m
<b>VOLTALIA</b>		<b>BUY</b>		<b>EUR13</b>
Last Price	EUR8,45	Market Cap.		EUR221m

## LOOKING BACK AT Q1 2016

The **Utilities sector** performed slightly better than the **Stoxx 600** (-5.3 % for SX6P vs. -7.7% for the Stoxx 600) during Q1 2016 after underperforming in Q4 2015 (+4.4% for SX6P vs. +5.2% for the Stoxx 600) and more importantly, after underperforming over all of 2015 (-3.7% for SX6P vs. +6.8% for the Stoxx 600). Since our initiation of coverage in July 2014, we have recommended staying out of the sector as a whole and playing it safe through stocks offering strong earnings growth equity stories based on restructuring efforts. After playing Veolia and Albioma during Q3 2015 and Q4 2015 we placed Suez on our BG Top Pick list for Q1 2016, as we expected two potential positive catalysts (*M&A deals & a deal with Engie*). Neither of these occurred and Suez's share price performance was limited over the quarter (-6.6%), **outperforming the Stoxx 600** but **underperforming the sector**. Inside the BG utilities universe, the top performer was **RWE** at -2.9%, followed by **Veolia** (-3.2%) and **E.ON** (-5.5%). The worst performers were **EDF** (-27%), **Volitalia** (-16.6%) and **Engie** (-16.4%). When looking inside the entire SX6P Index, most performers were regulated names, while underperformers were a mix of integrated utilities and renewables companies. During the period, European power prices (*forward FY1 power prices for France, Germany, Belgium, the UK and the Netherlands*) dropped by **20%** (-12% QoQ in Q4-15) while gas (*TTF*) prices continued to decline as over the first nine months, by around -12%, as well as coal prices with a drop of -4% in Q1 2016. Interestingly, during Q1, despite the decline observed in virtually all forward power price curves over the quarter, we started to see a stabilization in power prices in Germany and in France to the profit specifically of Clean Spark Spread margins (**gas assets**), in line with our view on the sector.

## WHAT WE EXPECT IN Q2 2016

Given that we do not expect a short term recovery in commodity prices in Europe, and given that the sector remains still strongly correlated to this, we prefer adopting a cautious view for Q2. In terms of potential catalysts only **Engie** and **E.ON** are set to organise an official "investor day" during the second quarter. However, we do not expect much from these events, except more clarity on the mid-term strategy at both groups, which have no choice but to adapt to the new energy world. Both stocks could react positively on the back of more clarification from management, but since the entities are still very highly dependent on commodity prices and political decisions, we think potential upside could be too low compared with downside, especially on a quarterly basis.

## CONCLUSIONS AND TOP PICKS

We have updated our models to include the latest **BG risk-free rate** and **risk-premium assumptions** (*respectively 1.6% vs. 2% previously and 7% versus 6.4% previously*) and integrated lower USD and stronger BRL assumptions, leading us to revise some of our Fair Values on the downside. We continue to see attractive valuations within the integrated utilities universe (*and still favour entities exposed to gas assets over entities exposed to coal assets*), while the environmental services subsector is already well priced-in. Our long term preference for renewables (*Volitalia & Albioma*) prevail, especially as earnings exposure to commodities is close to zero.

**For Q2 we have decided not to put any utilities stocks on the BG Top Picks list as we see very limited positive catalysts.**

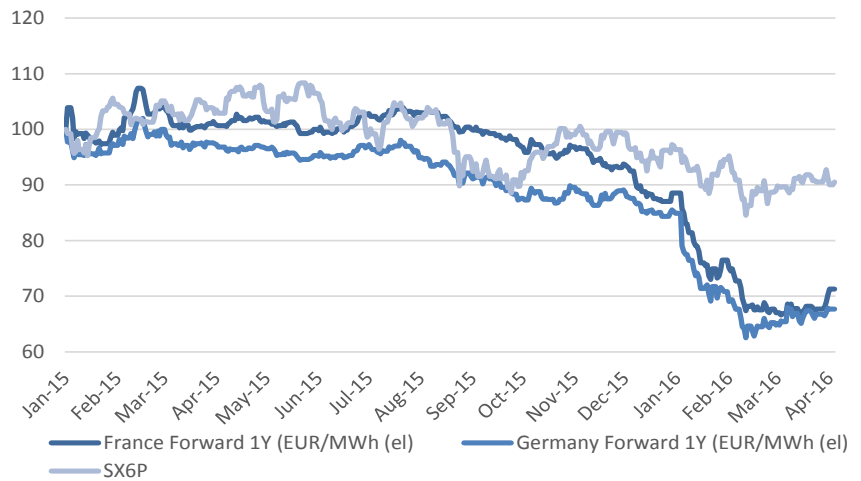
Below are the changes in FV made in our coverage following the integration of new **BG risk-free rate** and **risk-premium assumptions**:



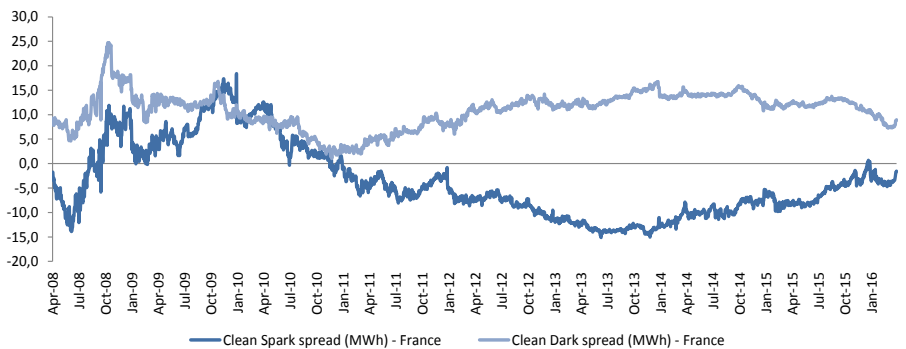
**Table 1:** BG Utilities – Change in FV

	New FV	Price	Upside	Previous FV	Change in FV
Albioma	16,0	13,3	20,2%	16	0,0%
E.ON	10,0	8,4	19,4%	10,2	-2,0%
EDF	13,5	10,1	34,3%	14,5	-6,9%
Engie	16,5	13,5	22,4%	17	-2,9%
Pennon	825,0	795,5	3,7%	825p	0,0%
RWE	9,5	11,7	-18,6%	9,8	-3,1%
Suez	18,5	15,9	16,1%	19	-2,6%
Veolia	22,0	20,7	6,2%	22,5	-2,2%
Voltaia	13,0	8,9	45,9%	13	0,0%

**Graph 1:** French & German forward power prices (EUR/MWh (el)), 2015-16 vs. SX6P



**Graph 2:** French power market – CDS vs. CSS (EUR/MWh (el))



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