

Sector View

Integrated Utilities

Potential upside from higher Brent for EDF & Engie

	1 M	3 M	6 M	31/12/15
Utilities	0.6%	6.3%	-4.5%	-1.7%
DJ Stoxx 600	2.5%	4.9%	-9.2%	-4.3%

*Stoxx Sector Indices

After following the massive commodities price fall over 2015, integrated utilities stocks have barely picked-up since the beginning of the year despite the recovery in oil prices, stability in European forward power prices and lower CO₂ prices. We have updated our models with new macro assumptions, prompting us to revise up our 2016-18e EPS by 1% on average and our FV by 1.6% on average. We continue to favour integrated utilities over environmental services stocks for 2016.

Companies covered

E.ON	BUY	EUR10.2 vs. 10
Last Price	EUR8.929	Market Cap. EUR17,867m
EDF	BUY	EUR13.8 vs. 13.5
Last Price	EUR12.22	Market Cap. EUR23,464m
ENGIE	BUY	EUR16.8 vs. 16.5
Last Price	EUR13.98	Market Cap. EUR34,045m
RWE	NEUTRAL	9.5
Last Price	EUR12.035	Market Cap. EUR7,270m

ANALYSIS

- Integrated utilities stocks have barely picked-up since the start of the year:** Since the beginning of the year the integrated utilities stocks we cover have not performed strongly compared with the sector and more importantly, compared with some commodities, despite being correlated to these when prices dropped in 2015. German integrated utilities stocks **E.ON and RWE have performed better than French stocks EDF and Engie** thanks to positive newsflow linked to potential agreements on nuclear dismantling. Note importantly that since the beginning of the year forward power prices in Europe (France & Germany mainly) have dropped by around **8%** but picked up since their low point in February (+20%) with indications of potential carbon floor prices implementation in France driving up prices. Over the same period, the EDF and Engie shares have decreased by respectively **10%** and **15%** on average while E.ON was flat and the RWE share has gained **2.5%**. The real recovery is coming from Brent prices, which surged by more than **40%** over the period (and +70% compared with low point) and are now close to **USD50/barrel**. **This recovery is positive for Engie and EDF predominantly**. We therefore see higher potential upside for these two stocks contrary to E.ON and RWE, which are no longer exposed to Brent prices following the disposals of E&P assets.
- We have updated our models to include our latest commodities/FX assumptions:** We have updated our model with our latest commodities assumptions and now assume a Brent price of **USD45/barrel** instead of **USD40/barrel** for 2016e and **USD49/barrel** for years after (take into account the latest spot price). We have also integrated lower CO₂ prices (EUR6/tonne vs. EUR8/tonne), higher coal prices (USD49/tonne vs. USD45/tonne) and stronger USD vs. EUR rate (1.11 vs. 1.13). We have made no change to our forward power prices assumptions for French entities as we were already at **EUR30/MWh** on average in models, but have revised down our assumptions for German forward prices from **EUR28/MWh to EUR26/MWh**. In all, on average we have revised up our 2016-18e EPS by **1%** while increasing our FV on average by **1.6%** with most of the changes being made for French names especially in view of the increase in Brent price assumptions (more details on page 2 with tables).
- Conclusion:** We maintain our positive view on integrated utilities as we continue to assume risk reward is quite attractive with a potential recovery in commodities prices and more importantly with positive potential newsflow in the pipe (carbon floor tax in France and in Germany and decisions on nuclear dismantling). Besides this, we believe investors will progressively start to look at a 2017 earnings recovery and 2017 valuations vs. 2016. **We still prefer Engie over EDF and E.ON over RWE.**



VALUATION

- At the current share price, the European integrated utilities sector is trading at **6.5x** 2016e EBITDA and offers a **6.4%** yield.

NEXT CATALYSTS

- 28th June: Engie Investor Day in Paris
- 28th July: Engie H1 2016 earnings
- 29th July 29: EDF H1 2016 earnings
- 10th August: E.ON H1 2016 earnings
- 11th August: RWE H1 2016 earnings

Our models for EDF, Engie, E.ON & RWE have been updated with our latest commodities assumptions:

EDF - FV up from EUR13.5 to EUR13.8/share – Buy rating confirmed

On average the group's EPS estimates are **up 0.9%** over 2016-18e following changes we have made to our assumptions. **Our new FV is EUR13.8/share and implies 13% upside.**

Engie - FV up from EUR16.5 to EUR16.8/share – Buy rating confirmed

On average the group's EPS are **up 2.0%** over 2016-18e following changes we have made to our assumptions. **Our EUR16.5/share FV based on Engie's transformation is up to EUR16.8/share** as we integrate a higher valuation from E&P business disposals linked to the Brent price recovery (*see our report: Engie: Rise of the phoenix? 08/03/2016*). Alongside EDF, Engie is the most exposed to any recovery in Brent prices and also to any rise in power prices in the region assuming carbon prices strongly surge.

E.ON - FV up from EUR10 to EUR10.2/share – Buy rating confirmed

On average the group's EPS are **up 1.2%** over 2016-18e following changes we have made to our assumptions. **Our new FV is EUR10.2/share and implies 15% upside. We still appreciate the group's considerable exposure to gas generation assets and its willingness to become a significant player within the renewables sector.**

RWE - FV unchanged at EUR9.5/share – Neutral rating confirmed

On average the group's EPS are **down 0.2%** over 2016-18e following changes we have made to our assumptions. **Our FV of EUR9.5/share remains unchanged and still implies 20% downside vs. the current price. In our view, RWE remains overly exposed to coal (higher coal price adjustments) and is at risk assuming a carbon floor tax is implemented. Besides this, the group is not yet sufficiently present in the renewables sector.**

Table 1: Changes in EPS assumptions for EDF, Engie, E.ON & RWE

Fair Value (EUR/share)	Before	Now	Change in %
EDF	13,5	13,8	2,2%
Engie	16,5	16,8	1,8%
E.ON	10,0	10,2	2,0%
RWE	9,5	9,5	0,0%

Source: Company Data; Bryan Garnier & Co. ests.

Table 2: Changes in EPS assumptions for EDF, Engie, E.ON & RWE

	Before			Now			Change			
	EPS 16e	EPS 17e	EPS 18e	EPS 16e	EPS 17e	EPS 18e	EPS 16e	EPS 17e	EPS 18e	Average
EDF	1,30	0,95	0,94	1,31	0,96	0,95	0,7%	1,0%	1,0%	0,9%
Engie	0,99	0,92	0,98	1,01	0,93	1,00	1,3%	2,1%	2,6%	2,0%
E.ON	0,80	0,71	0,65	0,79	0,75	0,65	-1,8%	5,9%	-0,5%	1,2%
RWE	0,72	0,89	0,63	0,79	0,87	0,59	8,7%	-2,3%	-7,0%	-0,2%
Average							2,2%	1,7%	-1,0%	1,0%

Source: Company Data; Bryan Garnier & Co. ests.

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