20th December 2016

Utilities

EDF

Price EUR9.76

Downgrade to neutral due to ongoing low earnings visibility

Fair Value EUR10,4 vs. EUR14,6 (+7%) **NEUTRAL vs. BUY**

Bloomberg	EDF FP
Reuters	EDF.PA
12-month High / Low (EUR)	13.7 / 9.2
Market Cap (EUR)	20,585
Ev (BG Estimates) (EUR)	82,708
Avg. 6m daily volume (000)	1 948
3y EPS CAGR	-25.8%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-0.4%	-10.7%	-12.7%	-28.1%
Utilities	6.9%	-4.4%	-4.0%	-10.2%
DJ Stoxx 600	6.0%	5.4%	10.4%	-1.7%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	75,006	74,664	72,961	73,843
% change		*-0.5%*	*-2.3%*	*1.2%*
EBITDA	17,601	16,009	14,062	15,632
EBIT	4,280	6,979	4,581	5,677
% change		*63.1%*	*-34.4%*	*23.9%*
Net income	4,231	2,924	1,230	1,864
% change		*-30.9%*	*-57.9%*	*51.5%*

	2015	2016e	2017e	2018e
Operating margin	5.7	9.3	6.3	7.7
Net margin	5.6	3.9	1.7	2.5
ROE	10.5	5.6	1.5	3.1
ROCE	2.0	2.8	2.0	2.4
Gearing	167.6	165.5	162.8	164.0

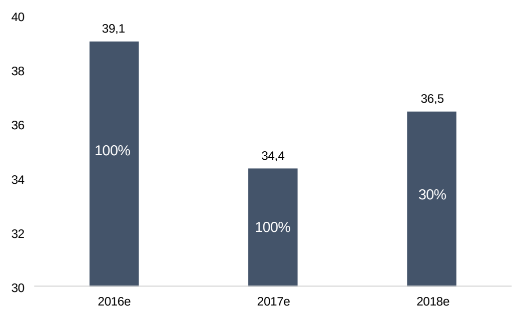
(EUR)	2015	2016e	2017e	2018e
EPS	2.27	1.46	0.61	0.93
% change	-	*-36.0%*	*-57.9%*	*51.6%*
P/E	4.3x	6.7x	15.9x	10.5x
FCF yield (%)	NM	NM	NM	8.8%
Dividends (EUR)	1.10	0.87	0.37	0.56
Div yield (%)	11.3%	9.0%	3.8%	5.7%
EV/Sales	1.1x	1.1x	1.1x	1.1x
EV/EBITDA	4.6x	5.2x	5.9x	5.4x
EV/EBIT	18.7x	11.9x	18.1x	14.8x

Following last week's unveiling of very disappointing 2017 EBITDA guidance (EUR13.7-14.3bn), we have completely rebuilt our power price model for France and the UK. Our 2017e/2018e estimates are significantly revised downward, so is our FV, now standing at EUR10.4 per share. We downgrade EDF to neutral due to the ongoing low visibility we have on the company's earnings, the upcoming capital increase, which should negatively weigh on the stock and the risks we see in nuclear provisions. In all, we would favour Engie over EDF due to the recently increased visibility on the stock notably following recent nuclear provisions announcement and upcoming disposals likely to act as positive catalysts.

ANALYSIS

- Last week, EDF unveiled **its 2017e EBITDA guidance** (between EUR13.7bn and EUR14.3bn), which was **9%** to **13%** below consensus expectations and which implies a **11%** to **16%** yoy decrease vs. the 2016e unchanged company EBITDA guidance (**EUR16.0-16.3bn**). The main reasons for this decrease were the **expected decrease in French and UK power prices** as well as higher ARENH volumes subscriptions for 2017. Since this announcement, the stock has clearly been under pressure (-12.9% vs. +1.2% for the Stoxx 600 Utilities).
- **We have completely rebuilt our power price model** and slashed our estimates for both the French and UK business divisions. EDF does not disclose its hedging policy, but we estimate a standard 3-year rolling policy would imply a c. **EUR4.5/MWh decrease in the company's achieved French and UK power prices in 2017 vs. 2016**. We additionally assume that ARENH volume subscriptions will have a c. **EUR300m** negative impact on the company's 2017e EBITDA, based on a 50TWh subscribed volumes' assumption for 2017. In all, **we now expect 2016e/2017e/2018e EBITDA to reach EUR16.0bn/EUR14.1bn/EUR15.6bn** respectively. After a significant drop in 2017, we expect a substantial rebound in 2018 notably given the current level of forward prices.

<u>Table 1:</u> BG assumptions for French power prices (2016e-2018e) – EUR/MWh



- **We have also integrated the expected disposal of a 49.9% stake in grid operator RTE which should bring up to EUR4.2bn cash-in for EDF in 2017**. This is the only expected disposal we have integrated in our model. All in all, **our FV** – based on an equally weighted valuation of three methods (SOTP, P/E ratio, Div. yield) – **now stands at EUR10.4 per share**, implying therefore a limited **7% theoretical upside** vs. current company's share price.

<u>Table 2:</u> BG key estimates (2016e-2018e)

	2016e	2017e	2018e
EBITDA	**16,009**	**14,062**	**15,632**
o/w France	*11,063*	*9,027*	*10,383*
o/w UK	*1,665*	*1,568*	*1,583*
EBIT	6,979	4,581	5,677
Net income	2,924	1,230	1,864
EPS	**1.46**	**0.61**	**0.93**
DPS	0.87	0.37	0.56

Source : Bryan Garnier & Co. ests.

- **Downgrade to neutral**: despite the recent strong derating (-12.9% performance since the profit warning), **we downgrade EDF to Neutral due to the high earnings volatility and the ongoing low visibility we have on the company's earnings** (nuclear outages, hedge policy not disclosed by the company), as shown by the three profit warnings over the last five months. In addition, **momentum appears rather poor** in our view with **the upcoming EUR4bn capital increase** (scheduled for March 2017) likely to negatively weigh on the stock on top of the uncertainty related to 2017 French presidential elections**. Finally, we see risks that nuclear provisions may be increased as EDF's used discount rate** (4.4%) **still appears uncorrelated to the market environment.** The company's reference document unveiled that **a 20bps decrease in the discount rate would imply a c. EUR1.2bn increase in provisions as well as a c. EUR600m headwind at the pre-tax income level**. As a reminder, last week, the discount rate used by Engie for its Belgian nuclear provisions has been revised downward by 130bps from 4.8% to 3.5%.

Table 3: **Nuclear provisions – sensitivity to discount rate**

Nuclear provisions France - sensitivity to discount rate					
	Amount in the balance sheet	**Balance sheet provisions**		**Pre-tax income**	
		+ 0,20%	**-0,20%**	**+ 0,20%**	**-0,20%**
Back-end nuclear cycle expenses					
⇨ Spent fuel management	10,391	(168)	177	140	(149)
⇨ Long-term radioactive waste management	8,254	(400)	448	337	(376)
Decommissioning and last cores					
⇨ Decommissioning of nuclear power plants	14,930	(496)	522	122	(131)
⇨ Last cores	2,555	-62	65	-	-
Total	**36,130**	**(1,126)**	**1,212**	**599**	**(656)**

Source : Company – 2015 Reference Document

- As for the dividend, our 2017e EPS estimate and our unchanged 60% payout ratio imply a mere **3.7% yield**, well below sector standards. As a reminder, EDF'd dividend policy implies a 55-65% payout ratio for 2016 and an **option for scrip dividends for both FY16 and FY17**. **This would imply further dilution at the EPS level.**
- **In all, we would favour Engie (Buy, FV @ EUR14.8) over EDF (Neutral, FV @ EUR10.4).** We believe **Engie's visibility has clearly been improved** over the past few weeks following the company's recent announcement over Belgian nuclear provisions. The "no-growth" scenario for 2016-2018 has been priced-in by the market and the consensus has already started to revise downward its initial estimates. **We now expect Engie to keep delivering its transformation plan with the awaited E&P assets' disposal still remaining the main short-term positive catalyst on the stock**.

VALUATION

- At the current share price, the stock trades at **5.2x** its 2016e EV/EBITDA multiple.
- **Neutral, FV @ EUR10.4** per share

NEXT CATALYSTS

- **14th February 2017:** FY-16 results

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