SOCIETE GENERALE
Cross Asset Research

EQUITY
24 November 2015

EQUITY SCREENER

| Electric Utilities | Trading update | United Kingdom |

Drax

In line trading update for H2 15 although market outlook remains challenging

Hold

Price 23/11/15	**233.2p**
12m target	**270p**
Upside to TP	**15.8%**
12m f'cast div	**5.26p**
12m TSR	**18.0%**

@ Go to SG website

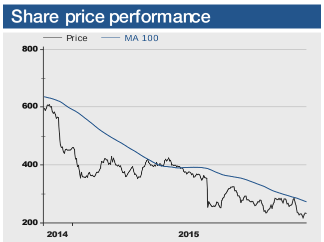
Sector stance
Underweight

Preferred stock
Engie

Least preferred stock
SSE, Fortum

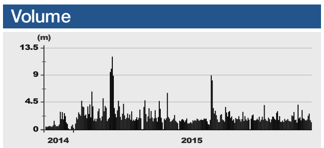
Investment trigger
Speculative appeal
New product development

Share price performance



Source: SG Cross Asset Research/Equity

Volume



Source: SG Cross Asset Research/Equity

Update Drax issued its scheduled trading update this morning covering the H2 period from 1 July 2015. Given the strong hedge position in the current year (>90%) Drax reiterated its 2015 EBITDA guidance range of £165-175m (SGe £165m/consensus £170m), although given the uncertainties (both regulatory and regarding power prices) pertaining to the 2016+ outlook, no EBITDA guidance is being provided for 2016 at this stage (c60% hedged at £47/MWh vs current forward power price of £39/MWh).

SG view Earnings remain highly sensitive to power price developments (£1/MWh power/spread change = 2% MV per year of shortfall), although the group could outperform on its £8.1/GJ biomass fuel guidance. In the absence of positive developments with regard to a third unit CfD or fourth unit subsidy funding (DECC's most recent policy statements indicate the 2016 allocation round would currently exclude biomass), investors are likely to continue to focus on the potential earnings risk on an MTM basis (2017 consensus EBITDA £153m vs SGe £136m – based upon £47/MWh power price).

How we value the stock Our 270p target price is based on a DCF valuation to 2027 and assumes 8.0% WACC for three coal units and three biomass units (RO regime). See page 3 for details. We estimate achieving a £105/MWh CfD rather than a ROC subsidy is potentially worth an additional 115p per unit, while we would value a fourth unit conversion at an incremental 140p (although we think the probability of both events occurring is very low).

Events, catalysts & risks We expect a State aid decision with regard to Lynemouth and Drax (to progress to Phase 2 investigation) around year-end. **Risks to TP**: upside – additional CfD unit conversions; improvements in power prices, coal and biomass spreads; downside – lower power prices and coal and biomass spreads; biomass sustainability changes.

Share data			
RIC DRX.L, Bloom DRX LN			
52-week range			609.5-217.1
EV 15 (£m)			1,443
Mkt cap. (£m)			944
Free float (%)			100.0
Performance (%)	**1m**	**3m**	**12m**
Ordinary shares	-17.7	-18.8	-60.9
Rel. Eurofirst 300	-18.2	-22.8	-63.9

Financial data	12/14	12/15e	12/16e	12/17e
Revenues (£bn)	2.81	3.01	3.31	3.39
EBIT margin (%)	5.3	2.6	1.4	1.5
Rep. net inc. (£m)	149	42.6	18.6	22.9
EPS (adj.) (p)	14.6	10.5	4.55	5.61
Dividend/share (p)	7.34	5.26	2.28	2.80
Payout (%)	20	50	50	50
Interest cover (x)	5.21	3.02	2.02	2.24
Net debt/equity (%)	6	3	3	2

Ratios	12/14	12/15e	12/16e	12/17e
P/E (x)	46.1	22.3	51.2	41.6
FCF yield (/EV) (%)	-9.6	3.4	-1.1	-0.4
Dividend yield (%)	1.1	2.3	1.0	1.2
Price/book value (x)	1.73	0.60	0.60	0.60
EV/revenues (x)	1.16	0.48	0.42	0.41
EV/EBIT (x)	21.9	18.1	29.8	26.8
EV/IC (x)	1.6	0.7	0.7	0.7
ROIC/WACC (x)	0.8	0.4	0.2	0.3

EPS CAGR 14-17e: -27.3%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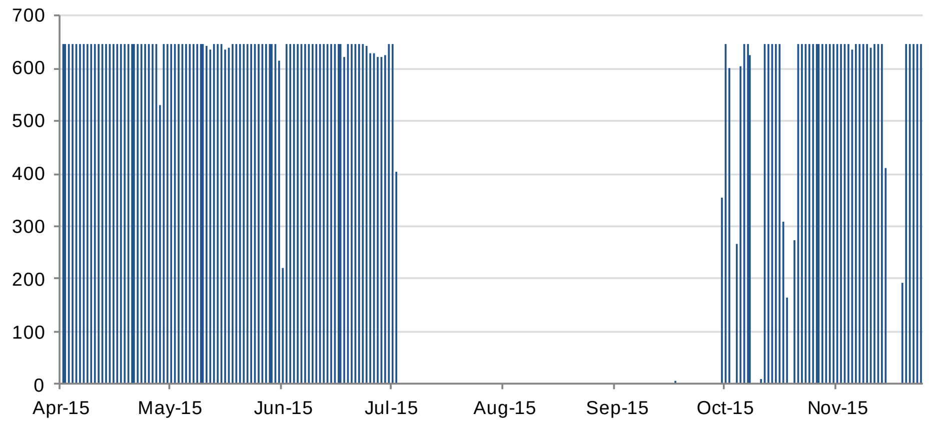
Trading update

The Drax trading update was in line with expectations.

Management reiterated its 2015 EBITDA guidance of £165m - £175m (SGe £165m/consensus £170m) which is to be expected given the group has now hedged 94% of its expected 2015 output.

Although we estimate the late return to full service of the first (Unit 2) biomass conversion unit has resulted in around 0.5 TWh of reduced output (c£10m EBITDA at assumed £20/MWh hedged bark spread), this has been offset by a "good operational performance", which as with the better than expected H1 results, we assume relates to lower than anticipated spot biomass pellet purchase costs (c£155/t ARA vs c£185/t ARA implicit in Drax's £8.1/GJ 2014 real biomass fuel cost guidance).

Drax Unit 2 – average daily notified output (MW)



Source: SG Cross Asset Research/Equity

Drax has extended its hedge position since the July interim results and we estimate is now 94% hedged for expected 2015 output. Since the last contracted position update (20 July) Drax has added 3.7 TWh to its 2016 contracted position at an estimated achieved power price of £43/MWh (marginally ahead of the average traded price of the 2016 calendar forward of £42/MWh over the period). The fixed price contracted position of 15.5 TWh for 2016 delivery compares to the 13.2 TWh of year ahead contracted output as at 27 October 2014 – suggesting that Drax is continuing to hedge forward despite the reduction in both biomass and coal forward spreads.

Drax – contracted power sales

	2015 TWh	2015 Achieved power price £/MWh	2016 TWh	2016 Achieved power price £/MWh
Fixed price sales as at 16 Nov	26.1	49.6	15.5	47.2
Fixed margin sales at 16 Nov	0.0	-	2.5	-
Total power sales hedged	26.1		18.0	
Yet to hedge	1.7	44.0	10.2	46.0
Total power sales forecast	27.8	49.3	28.2	46.7
Hedged since last update	2.5	47.7	3.7	43.1

Source: SG Cross Asset Research/Equity

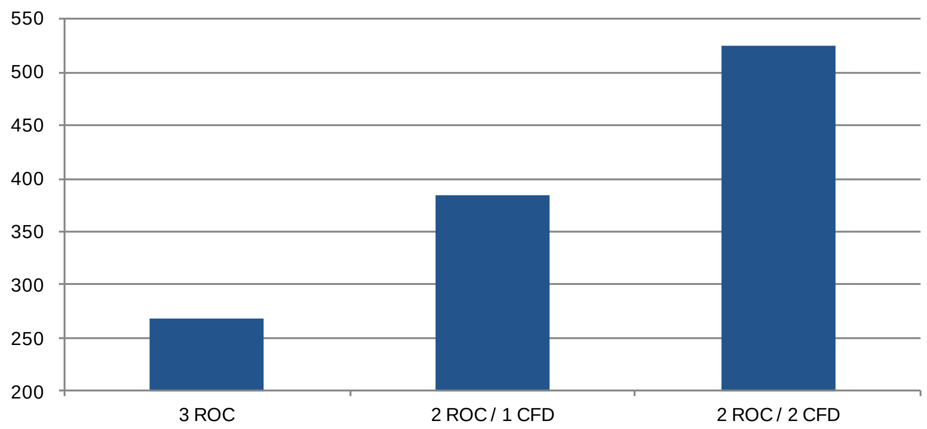
Drax valuation

Drax – SGe sum-of-the-parts valuation (3x ROC scenario)

Valuation	£m	Per share
Coal output	440	108
3 x ROC (carbon flat real post 2020)	296	73
Pellet Plant Value Add	29	7
Total EV value 3 unit conversion	765	188
Net cash as at Dec 2012*	311	76
Working capital	225	55
Pension deficit	-42	-10
Deferred tax (10 yr NPV)	-127	-31
Decommissioning costs (adj)	-40	-10
Total equity value 3 unit conversion	1,093	268

Source: SG Cross Asset Research/Equity * Starting date of biomass conversions

Drax biomass conversion valuation sensitivity (in pence)



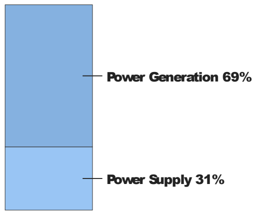
Source: SG Cross Asset Research/Equity

Drax – Summary income statement

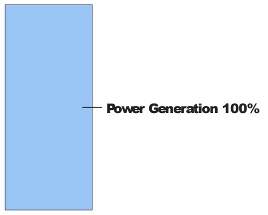
£m	2012	2013	2014	2015E	2016e	2017e	2018e	2019e	2020e
Achieved power price £/MWh	51.3	46.7	51.3	49.0	47.1	46.6	47.8	49.0	50.2
Achieved coal price $/t	103.7	103.7	100.0	80.3	75.5	70.8	72.8	75.0	77.2
Biomass cost £/MWh	7.4	7.6	7.5	7.7	7.7	7.9	8.1	8.3	8.5
Coal output	27.1	23.2	18.8	18.9	14.2	14.2	13.3	12.5	11.7
Biomass output	1.2	2.9	7.9	8.9	14.0	14.5	14.5	14.5	14.5
Total output	28.2	26.1	26.7	27.8	28.2	28.7	27.9	27.0	26.2
Coal spread	19.9	18.7	16.8	14.5	9.9	10.3	10.9	11.5	12.1
Bark spread ROC		23.4	25.2	22.6	19.9	18.7	19.2	19.9	19.3
Bark spread CfD		22.0	23.2	22.6	23.8	24.4	25.0	25.6	26.2
EBITDA	298.3	230.0	225.8	164.9	131.4	136.2	147.9	185.1	185.3
D&A	-58.5	-64.8	-80.7	-85.2	-84.9	-84.5	-74.2	-65.3	-57.7
Operating profit	239.8	165.2	145.1	79.6	46.5	51.7	73.8	119.8	127.7
Net interest	-13.6	-23.2	-28.6	-26.3	-23.1	-23.1	-22.9	-20.3	-17.8
Exceptionals	-36.1	-110.2	65.8	0.0	0.0	0.0	0.0	0.0	0.0
PTP	190	32	182	53	23	29	51	100	110
Tax	-26.4	19.6	-41.8	-10.7	-4.9	-5.7	-9.7	-18.9	-23.1
Tax rate		-62%	23%	20%	21%	20%	19%	19%	21%
PAT	164	51	141	43	19	23	41	81	87
Shares basic	372	402	404	405	408	408	408	408	408
Shares diluted	375	407	407	408	408	408	408	408	408
EPS adj.	51.9	35.3	14.7	10.5	4.6	5.6	10.1	19.8	21.3
DPS	25.3	17.6	7.3	5.3	2.3	2.8	8.1	15.8	17.0

Source: SG Cross Asset Research/Equity

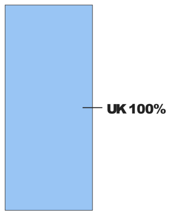
Sales/division 14



EBIT/division 14



Sales/region 14



Major shareholders (%)

Invesco	26.0
Schroders	12.5
Artemis	5.3

Source: SG Cross Asset Research/Equity

Drax

Valuation (£m)	12/10	12/11	12/12	12/13	12/14	12/15e	12/16e	12/17e
Nb. of shares basic year end/outstanding	365	365	402	402	405	405	408	408
Share price (average) (p)	383	472	530	638	672	233	233	233
Average market cap. (SG adjusted) (1)	1,396	1,721	2,130	2,566	2,721	944	951	951
Restated net debt (-)/cash (+) (2)	-405	-468	-227	-387	-477	-439	-384	-385
Value of minorities (3)								
Value of financial investments (4)								
Other adjustment (5)	68	68	73	73	65	60	54	49
EV = (1) - (2) + (3) - (4) + (5)	1,869	2,258	2,430	3,025	3,263	1,443	1,389	1,384
P/E (x)	6.0	8.6	10.3	18.2	46.1	22.3	51.2	41.6
Price/cash flow (x)	3.4	8.7	9.8	18.2	31.8	5.0	10.5	9.5
Price/free cash flow (x)	4.01	11.2	nm	nm	nm	12.5	120	55.0
Price/book value (x)	1.46	1.32	1.44	1.82	1.73	0.60	0.60	0.60
EV/revenues (x)	1.13	1.23	1.37	1.47	1.16	0.48	0.42	0.41
EV/EBITDA (x)	4.8	6.8	8.1	13.2	14.2	8.8	10.6	10.2
Dividend yield (%)	8.4	5.9	4.8	2.8	1.1	2.3	1.0	1.2
Per share data (p)								
SG EPS (adj.)	63.6	55.1	51.4	35.0	14.6	10.5	4.55	5.61
Cash flow	112	54.0	54.1	35.0	21.2	46.3	22.2	24.5
Book value	263	357	368	350	388	389	388	391
Dividend	32.0	27.8	25.3	17.6	7.34	5.26	2.28	2.80
Income statement (£m)								
Revenues	1,648	1,836	1,780	2,062	2,805	3,010	3,315	3,389
Gross income	550	501	511	445	450	404	375	384
EBITDA	392	334	298	230	230	165	131	136
Depreciation and amortisation	-52	-57	-59	-65	-81	-85	-85	-85
EBIT	339	276	240	165	149	80	47	52
Impairment losses	0	0	0	0	0	0	0	0
Net interest income	-24	-28	-14	-23	-29	-26	-23	-23
Exceptional & non-operating items	-61	90	-36	-110	66	0	0	0
Taxation	-67	127	-26	20	-37	-11	-5	-6
Minority interests			0	0				
Reported net income	188	465	164	51	149	43	19	23
SG adjusted net income	233	202	193	142	59	43	19	23
Cash flow statement (£m)								
EBITDA	392	334	298	230	230	165	131	136
Change in working capital	115	-50	-35	-60	-102	86	-7	-2
Other operating cash movements	-95	-85	-60	-27	-41	-63	-34	-34
Cash flow from operating activities	411	199	203	142	86	189	90	100
Net capital expenditure	-62	-44	-206	-302	-200	-113	-83	-83
Free cash flow	349	155	-3	-159	-114	76	8	17
Cash flow from investing activities	-40	65	0	10	-20	0	0	0
Cash flow from financing activities	-153	-253	172	45	44	-21	-9	-11
Net change in cash resulting from CF	156	-33	169	-104	-90	55	-1	6
Balance sheet (£m)								
Total long-term assets	1,221	1,217	1,418	1,627	1,819	1,846	1,844	1,842
of which intangible	0	0	0	0	0	0	0	0
Working capital	-177	137	48	131	334	248	255	257
Employee benefit obligations	37	37	42	42	34	29	23	18
Shareholders' equity	958	1,303	1,477	1,410	1,573	1,574	1,583	1,595
Minority interests	0	0	0	0	0	0	0	0
Provisions	6	31	32	32	30	30	30	30
Net debt (-)/cash (+)	204	225	311	71	-99	-44	-45	-39
Accounting ratios								
ROIC (%)	21.2	18.5	14.7	9.4	6.2	3.2	1.9	2.1
ROE (%)	19.0	41.1	11.8	3.6	10.0	2.7	1.2	1.4
Gross income/revenues (%)	33.4	27.3	28.7	21.6	16.0	13.4	11.3	11.3
EBITDA margin (%)	23.8	18.2	16.8	11.2	8.2	5.5	4.0	4.0
EBIT margin (%)	20.6	15.1	13.5	8.0	5.3	2.6	1.4	1.5
Revenue yoy growth (%)	11.7	11.4	-3.1	15.9	36.0	7.3	10.1	2.3
Rev. organic growth (%)	11.7	11.4	-3.1	15.9	36.0	7.3	10.1	2.3
EBITDA yoy growth (%)	10.5	-14.8	-10.6	-22.9	-0.2	-28.2	-20.3	3.7
EBIT yoy growth (%)	12.1	-18.6	-13.2	-31.1	-9.9	-46.5	-41.5	11.1
EPS (adj.) yoy growth (%)	9.9	-13.5	-6.7	-31.9	-58.3	-28.3	-56.5	23.2
Dividend growth (%)	nm	-13.1	-9.0	-30.4	-58.3	-28.3	-56.8	23.2
Cash conversion (%)	112.5	70.3	14.2	nm	nm	75.8	-21.9	-0.2
Net debt/equity (%)	nm	nm	nm	nm	6	3	3	2
FFO/net debt (%)	74.3	92.2	114.0	58.6	34.4	29.1	26.9	27.9
Dividend paid/FCF (%)	24.8	80.0	nm	nm	nm	28.0	117.2	66.2

APPENDIX

COMPANIES MENTIONED

Drax (DRX.L, Hold)
Engie (ENGIE.PA, Buy)
Fortum (FUM1V.HE, Sell)
SSE (SSE.L, Sell)

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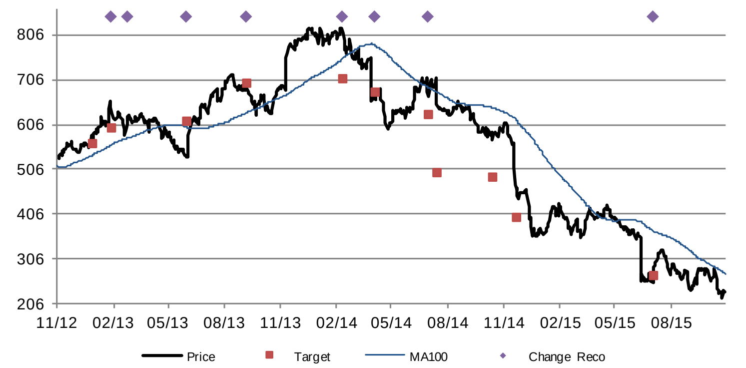
Historical Price: Drax (DRX.L)



2012/2013	Change	2014/2015	Change
21/01/13	New Target: 565.0	06/03/14	New Rating: Sell
21/02/13	New Rating: Sell	06/03/14	New Target: 710.0
21/02/13	New Target: 600.0	28/04/14	New Rating: Hold
20/03/13	New Rating: Hold	28/04/14	New Target: 680.0
24/06/13	New Rating: Buy	24/07/14	New Rating: Sell
24/06/13	New Target: 615.0	24/07/14	New Target: 630.0
30/09/13	New Rating: Hold	07/08/14	New Target: 500.0
30/09/13	New Target: 700.0	06/11/14	New Target: 490.0
		15/12/14	New Target: 400.0
		27/07/15	New Rating: Hold
		27/07/15	New Target: 270.0

Source: SG Cross Asset Research/Equity

SG EQUITY RESEARCH RATINGS on a 12 months period

BUY: absolute total shareholder return forecast of 15% or more over a 12 month period.

HOLD: absolute total shareholder return forecast between 0% and +15% over a 12 month period.

SELL: absolute total shareholder return forecast below 0% over a 12 month period.

Total shareholder return means forecast share price appreciation plus all forecast cash dividend income, including income from special dividends, paid during the 12 month period. Ratings are determined by the ranges described above at the time of the initiation of coverage or a change in rating (subject to limited management discretion). At other times, ratings may fall outside of these ranges because of market price movements and/or other short term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by research management.

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OVERWEIGHT: sector expected to outperform the relevant broad market benchmark over the next 12 months.

NEUTRAL: sector expected to perform in-line with the relevant broad market benchmark over the next 12 months.

UNDERWEIGHT: sector expected to underperform the relevant broad market benchmark over the next 12 months.

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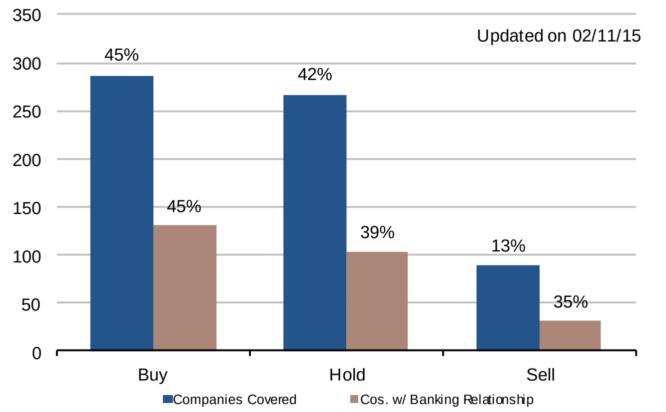
Equity rating and dispersion relationship



Source: SG Cross Asset Research/Equity

All pricing information included in this report is as of market close, unless otherwise stated.

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Engie	SG acted as passive joint bookrunner in GDF Suez's bond issue.
Engie	SG acted as joint dealer manager in GDF SUEZ's tender offer (targeting some 10/2017, 02/2021, 07/2022, 10/2022, 02/2023 bonds).

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SG or its affiliates have received compensation for investment banking services in the past 12 months from Engie.
SG or its affiliates managed or co-managed in the past 12 months a public offering of securities of Engie.
SG received compensation for products and services other than investment banking services in the past 12 months from Drax, Engie, Fortum, SSE.
SGAS had a non-investment banking non-securities services client relationship during the past 12 months with Drax, Engie.
SGAS received compensation for products and services other than investment banking services in the past 12 months from Drax, Engie.

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