



Multi-Utilities & Unregulated Power | **Corporate news** | Germany |

RWE

Introducing ZDP – Zero Dividend Policy

Hold

Price 16/02/16 **€11.8**
12m target **€12.0**
Upside to TP **1.7%**
12m f'cast div **€0.50**
12m TSR **5.9%**

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Sector stance (equity strategists)

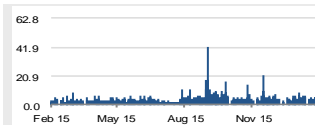
Underweight
Preferred stock
Enel, Suez, Enagas, E.ON
Least preferred stock
SSE, Centrica

Share price performance



Source: SG Cross Asset Research/Equity

Volume



Source: SG Cross Asset Research/Equity

Update This morning RWE issued an ad hoc press release announcing that the ordinary dividend for 2015 will be suspended and the preference shares will get a dividend of €0.13 per share. RWE also announced that FY2015 results were in line with expectations with an operating result of €3.8bn (SGe: €3.72bn) and adj. net income of €1.1bn (SGe: €1.15bn). For 2015 RWE also took a €2.1bn impairment charge for German and UK generating assets, which should not surprise given the collapse in power prices. The outlook for 2016, which is still partly protected by hedges, is for an operating result of €2.8-3.1bn (SGe: €3.08bn).

SG view Neither the headline numbers for FY2015 nor outlook for 2016 were a surprise, so it's all about the dividend. Consensus expectations were for a 2015 dividend of €0.50 (down from €1.00 in 2014), so not paying any ordinary dividend at all for 2015 – the company made it clear the suspension only refers to 2015 – saves RWE about €300m. According to management the decision was taken in the face of the relentless slump in German power prices, which are now close to €20/MWh across the curve. We doubt that many RWE shareholders were holding RWE for the dividend appeal – the nuclear catalysts plus a re-rating of NewCo post IPO seem more plausible candidates for investing in RWE. Perhaps the *reason* for the cut – collapsing power prices – is of greater concern than the cut itself. At €20/MWh some of RWE's lignite plants still cover their cash cost, but the overall unit is loss-making. It is debatable whether power prices at €20/MWh are sustainable when most German conventional generation is under water at this level, but if we were to mark-to market current forward curves our TP for RWE would drop from €12 to €9.50. We doubt that 'ZDP' – zero dividend policy – will catch on in the sector. While falling power prices are also a concern for E.ON, the €0.50 dividend is guaranteed, which confirms our view that E.ON is the safer way to play the potential upside from the nuclear catalysts.

How we value the stock We value RWE on a sum of parts (see page 3) at €11.8 and round it up to €12 (as we do for all our stocks to the nearest €0.50).

Risks to price target, rating & recommendation See page 3

Share data			
RIC RWEGR.DE, Bloom RWE GR			
52-week range	25.1-9.20		
EV 15 (€m)	42,695		
Mkt cap. (€m)	7,254		
Free float (%)	84.0		
Performance (%)	1m	3m	12m
Ordinary shares	9.0	5.2	-50.5
Rel. Eurofirst 300	12.0	21.7	-41.0

Financial data	12/14	12/15e	12/16e	12/17e	Ratios	12/14	12/15e	12/16e	12/17e
Revenues (€bn)	48.5	50.3	50.8	51.6	P/E (x)	13.8	6.3	11.1	7.9
EBIT margin (%)	8.3	7.4	6.1	7.1	FCF yield (/EV) (%)	7.6	4.6	6.2	7.8
Rep. net inc. (€bn)	1.70	2.50	0.50	0.68	Dividend yield (%)	3.5	4.2	4.2	5.1
EPS (adj.) (€)	2.09	1.87	1.06	1.48	Price/book value (x)	2.40	0.78	0.77	0.53
Dividend/share (€)	1.00	0.50	0.50	0.60	EV/revenues (x)	1.18	0.85	0.82	0.72
Payout (%)	48	27	47	40	EV/EBIT (x)	14.2	11.5	13.6	10.1
Interest cover (x)	3.72	3.68	3.05	3.62	EV/IC (x)	1.3	1.1	1.1	1.0
Net debt/equity (%)	72	45	37	nm	ROIC/WACC (x)	0.7	0.8	0.7	0.8
Previous EPS		1.79	1.04	1.61	EPS CAGR 14-17e: -10.7%				

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2015 dividend: And then there was none...

The state of RWE's balance sheet has been subject to some debate as collapsing power prices and adverse political decisions have left their mark. For 2016 we see net debt/EBITDA of 4.5x, although that is benefitting from a €2bn equity credit from RWE's €4bn worth of hybrid bonds. We see 2016 RCF/net debt of 13.4%. Rather more importantly, Moody's sees RWE's RCF/net debt at 11.9%, which is in line with the "low teens" required for RWE's current rating of Baa2. We do not believe that another downgrade of RWE's credit rating is on the cards, despite Moody's commodity price driven review of a number of commodity exposed utilities.

We also do not believe that RWE will require a rights issue, even if power prices stay at the current level. Just selling 10% of NewCo will see net debt/EBITDA fall to 3.2x by 2017 and should drive RCF/net debt to almost 20%.

The share price reaction this morning – down €1.65, or 14% - seems overdone in our view. The loss of the 2015 dividend is likely to be a one-off, assuming RWE is still serious about the IPO of NewCo. While the concern over power prices is justified, it is difficult to argue that this could have come as a surprise. While a potential re-rating for RWE NewCo is likely to be a 2017 story, the nuclear catalysts are still likely to emerge in 2016 and promise significant upside. However, we continue to prefer E.ON over RWE because of:

- the dividend (which was the case even before RWE introduced a ZDP)
- the balance sheet (unlike RWE, E.ON does not have any hybrid bonds)
- State Aid (RWE will receive payments for 1.5GW of lignite capacity that will be transferred into the capacity reserve)

Valuation & Risks to recommendation, rating and target price

E.ON - SGe Sum-of-the-parts

	EV €m	EBITDA 16E €m	EV/EBITDA x	€/ps
Generation	2,236	793	2.8x	1.1
Renewables	16,625	1,454	11.4x	8.5
Global Commodities*	1,921	384	5.0x	1.0
E&P	1,632	307	5.3x	0.8
Germany	17,837	1,889	9.4x	9.1
Other EU	13,621	1,932	7.1x	7.0
Russia	2,116	459	4.6x	1.1
GM Other	(3,312)	(552)	6.0x	(1.7)
TOTAL EV	52,676	6,666	7.9x	27.0
Net financial debt	(3,671)			(1.9)
Pension liabilities	(5,528)			(2.8)
Nuclear liabilities	(19,058)			(9.8)
Other liabilities	(1,571)			(0.8)
Minorities	(2,428)			(1.2)
EQUITY VALUE/TP	20,420			10.5

Source: SG Cross Asset Research/Equity; valuation based on 2017E EBITDA.

Downside risks – E.ON:

- Further rouble depreciation; a decline of R10 in the EUR/RUB exchange rate would take our EPS down by 2-3%.
- Lower power prices; losing €1/MWh on base and peak load prices across the curve would knock 3-4% off unhedged EPS.
- Each 10% reduction in the load factor for hydro would reduce unhedged EPS by 4%.

RWE

RWE – SGe sum-of-the-parts

	EBITDA 2016E	EV/EBITDA (implied)	Method	EV
Power Generation - Western Europe	889	4.6x	DCF	4,120
Power Generation - UK	128	5.4x	DCF	693
Supply/Distribution Networks Germany	2,342	9.4x	DCF	22,068
Supply Netherlands/Belgium	244	8.3x	DCF	2,039
Supply UK	211	7.3x	DCF	1,542
Central Eastern and South Eastern Europe	927	7.7x	DCF	7,116
Renewables	731	7.4x	DCF	5,406
Trading/Gas Midstream	259	4.0x	Multiple	1,035
Other, consolidation	(175)	7.5x	Multiple	- 1,313
Group	5,556	7.7x		42,706
Net debt RWE Group	2015E			- 25,787
Other provisions	2015E		P/Book	- 5,185
Minorities	2015E	1.0 X	1.1 X	- 3,328
Other financial assets & property				898
Hybrid adjustment				(2,039)
Equity value (EURm)				7,265
Shares				614.75
Equity value (EUR)				11.80

Source: SG Cross Asset Research/Equity

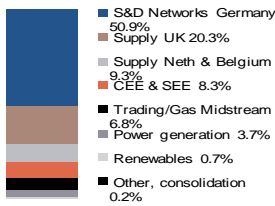
Downside risks – RWE:

- If capacity payments for lignite are deemed to be ‘State aid’, our valuation would fall by -€0.70, were said ‘State aid’ were to be prohibited.
- Lower power prices; losing €1/MWh on base and peak load prices across the curve would reduce our TP by -€0.60 per share.

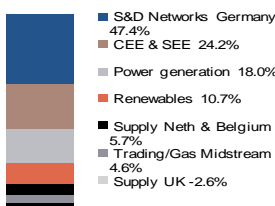
Upside risks – RWE:

- Higher power prices; a gain of €1/MWh on base and peak load prices across the curve would increase our valuation by +€0.60 per share.
- Ruling on nuclear fuel tax in RWE’s favour; if the nuclear fuel tax is repealed and previous payments reimbursed, this would increase our valuation for RWE by €3 per share.
- A potential re-rating of the NewCo, post spin-off. We currently value the NewCo in our SOP at 8.6x EV/EBITDA. If the NewCo multiple expands to 9.0x EV/EBITDA, our valuation of RWE would rise by €3.10

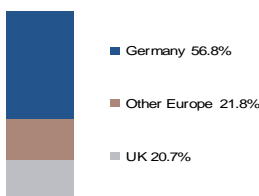
Sales/division 14



EBIT/division 14



Sales/region 14



Major shareholders (%)

RWEB GmbH	15.0
RWE employees	1.0

RWE

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	562	614	615	615	615	615	615	615
Share price (average)	57.0	37.6	32.6	26.3	28.8	11.8	11.8	11.8
Average market cap. (SG adjusted) (1)	32,071	23,066	20,066	16,193	17,699	7,254	7,254	7,254
Restated net debt (-)/cash (+) (2)	-11,904	-12,239	-33,015	-30,727	-29,924	-25,787	-24,812	-19,720
Value of minorities (3)	0	0	3,328	3,328	3,328	3,328	3,328	3,328
Value of financial investments (4)	0	0	898	898	898	898	898	898
Other adjustment (5)	29,057	29,156	6,585	7,902	7,049	7,225	7,406	7,594
EV = (1) - (2) + (3) - (4) + (5)	73,032	64,461	62,095	57,251	57,102	42,695	41,902	36,998
P/E (x)	8.5	13.1	8.2	7.0	13.8	6.3	11.1	7.9
Price/cash flow (x)	7.0	2.7	4.6	3.4	3.2	2.2	2.0	1.9
Price/free cash flow (x)	nm	7.27	nm	16.9	7.66	8.86	4.97	3.98
Price/book value (x)	2.20	1.94	1.65	2.09	2.40	0.78	0.77	0.53
EV/revenues (x)	1.37	1.27	1.17	1.09	1.18	0.85	0.82	0.72
EV/EBITDA (x)	7.0	7.6	6.7	7.2	8.0	6.9	7.5	6.1
Dividend yield (%)	6.1	5.4	6.1	3.8	3.5	4.2	4.2	5.1
Per share data (€)								
SG EPS (adj.)	6.68	2.87	4.00	3.76	2.09	1.87	1.06	1.48
Cash flow	8.11	13.8	7.15	7.81	9.04	5.45	5.77	6.25
Book value	25.9	19.4	19.8	12.6	12.0	15.1	15.4	22.2
Dividend	3.50	2.02	2.00	1.00	1.00	0.50	0.50	0.60
Income statement (€m)								
Revenues	53,320	50,864	53,227	52,425	48,468	50,251	50,803	51,568
Gross income	10,427	8,460	53,227	52,425	48,468	50,251	50,803	51,568
EBITDA	10,427	8,460	9,314	7,904	7,131	6,175	5,556	6,114
Depreciation and amortisation	-2,746	-2,690	-2,898	-2,535	-3,114	-2,454	-2,475	-2,459
EBIT	7,681	5,770	6,416	5,369	4,017	3,722	3,082	3,655
Impairment losses	0	0	-3,051	-6,023	-48	-170	0	0
Net interest income	-2,703	-2,790	-2,092	-1,905	-1,848	-1,450	-1,464	-1,442
Exceptional & non-operating items	0	0						
Taxation	-1,376	-854	-526	-739	-553	-648	-636	-886
Minority interests	-294	-364	-398	-314	-353	-475	-483	-643
Reported net income	3,308	1,762	1,306	-2,757	1,704	2,503	499	683
SG adjusted net income	3,754	1,762	2,457	2,314	1,282	1,150	654	913
Cash flow statement (€m)								
EBITDA	10,427	8,460	9,314	7,904	7,131	6,175	5,556	6,114
Change in working capital	-2,557	2,500	-1,190	-65	1,476	461	339	230
Other operating cash movements	-3,312	-2,487	-3,729	-3,036	-3,051	-3,283	-2,348	-2,499
Cash flow from operating activities	4,558	8,473	4,395	4,803	5,556	3,353	3,548	3,845
Net capital expenditure	-6,356	-5,300	-5,081	-3,843	-3,245	-2,535	-2,089	-2,022
Free cash flow	-1,798	3,173	-686	960	2,311	819	1,459	1,823
Cash flow from investing activities	3,011	2,200	1,815	1,948	906	3,195	-105	-105
Cash flow from financing activities	-3,250	-2,678	-1,229	-1,229	-615	-615	-307	-307
Net change in cash resulting from CF	-2,037	2,695	-100	1,679	2,602	3,399	1,046	1,410
Balance sheet (€m)								
Total long-term assets	59,983	62,926	63,338	56,905	54,224	51,110	50,829	50,497
of which intangible	17,350	16,946	0	0	0	0	0	0
Working capital	-1,408	-4,642	-151	-1,999	-367	-1,148	-1,815	-2,533
Employee benefit obligations	0	0	6,856	6,227	7,871	5,976	6,096	6,217
Shareholders' equity	14,574	11,889	12,171	7,738	7,388	9,276	9,467	13,674
Minority interests	1,084	1,344	4,318	4,399	4,384	4,384	4,384	4,384
Provisions	23,485	23,829	21,135	21,124	19,669	19,180	18,968	18,755
Net debt (-)/cash (+)	-11,904	-12,239	-12,335	-10,320	-8,519	-6,144	-5,098	69
Accounting ratios								
ROIC (%)	12.3	8.6	8.9	7.6	6.2	6.1	5.4	6.6
ROE (%)	24.2	13.3	10.9	-27.7	22.5	30.0	5.3	5.9
Gross income/revenues (%)	19.6	16.6	100.0	100.0	100.0	100.0	100.0	100.0
EBITDA margin (%)	19.6	16.6	17.5	15.1	14.7	12.3	10.9	11.9
EBIT margin (%)	14.4	11.3	12.1	10.2	8.3	7.4	6.1	7.1
Revenue yoy growth (%)	11.8	-4.6	4.6	-1.5	-7.5	3.7	1.1	1.5
Rev. organic growth (%)	11.8	-4.6	3.0	-1.5	-7.5	3.7	1.1	1.5
EBITDA yoy growth (%)	9.6	-18.9	10.1	-15.1	-9.8	-13.4	-10.0	10.0
EBIT yoy growth (%)	8.3	-24.9	11.2	-16.3	-25.2	-7.4	-17.2	18.6
EPS (adj.) yoy growth (%)	6.1	-57.0	39.3	-5.9	-44.6	-10.3	-43.2	39.6
Dividend growth (%)	0.0	-42.3	-0.9	-50.0	0.0	-50.0	0.0	20.0
Cash conversion (%)	19.7	98.1	10.9	55.7	102.0	70.1	105.5	103.5
Net debt/equity (%)	76	92	75	85	72	45	37	nm
FFO/net debt (%)	53.3	39.4	20.3	17.1	15.8	15.8	13.9	19.2
Dividend paid/FCF (%)	nm	67.7	nm	64.0	26.6	37.5	21.1	20.2

Source: SG Cross Asset Research/Equity

APPENDIX

COMPANIES MENTIONED

- Centrica (CNA.L, Sell)
- E.ON (EONGn.DE, Buy)
- Enagas (ENAG.MC, Buy)
- Enel (ENEL.MI, Buy)
- Norsk Hydro (NHY.OL, No Reco)
- RWE (RWE.G.DE, Hold)
- SSE (SSE.L, Sell)
- Suez (SEVI.PA, Buy)

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Historical Price: RWE (RWE.G.DE)



2013/2014	Change	2015/2016	Change
06/03/13	New Target: 24.0	13/04/15	New Rating: Sell
01/07/13	New Target: 22.0	13/04/15	New Target: 22.4
18/09/13	New Target: 21.0	14/05/15	New Target: 17.5
15/11/13	New Target: 20.0	03/07/15	New Rating: Hold
12/05/14	New Target: 22.0	03/07/15	New Target: 21.0
18/12/14	New Rating: Hold	18/08/15	New Rating: Sell
18/12/14	New Target: 28.0	18/08/15	New Target: 15.0
		11/09/15	New Target: 12.5
		02/10/15	New Rating: Hold
		02/10/15	New Target: 10.0
		12/10/15	New Rating: Buy
		12/10/15	New Target: 14.0
		17/11/15	New Rating: Hold
		17/11/15	New Target: 12.0

Source: SG Cross Asset Research/Equity

SG EQUITY RESEARCH RATINGS on a 12 month 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.

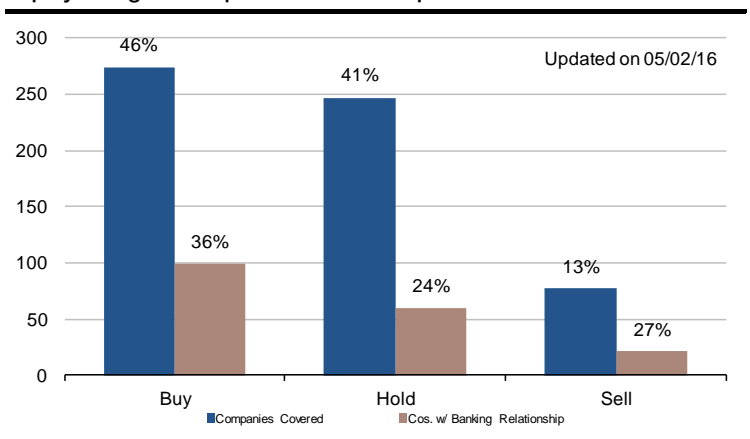
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OVERWEIGHT: sector expected to outperform the relevant broad market benchmark over the next 12 months.

NEUTRAL: sector expected to perform in-line with the

Equity rating and dispersion relationship



Source: SG Cross Asset Research/Equity

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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Enagas	SG acted as passive bookrunner for Enagas's bond issue (8y EUR).
Enel	SG makes a market in Enel warrants

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SG or its affiliates expect to receive or intend to seek compensation for investment banking services in the next 3 months from Enagas, Enel, RWE, Suez.

SG or its affiliates had an investment banking client relationship during the past 12 months with Enagas.

SG or its affiliates have received compensation for investment banking services in the past 12 months from Enagas.

SG or its affiliates managed or co-managed in the past 12 months a public offering of securities of Enagas.

SG received compensation for products and services other than investment banking services in the past 12 months from Centrica, E.ON, Enagas, Enel, Norsk Hydro, RWE, SSE, Suez.

SGAS had a non-investment banking non-securities services client relationship during the past 12 months with Centrica, E.ON, Norsk Hydro, RWE.

SGAS received compensation for products and services other than investment banking services in the past 12 months from Centrica, E.ON, Norsk Hydro, RWE.

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