

German Utilities

Carbon carnival ahead of 2016 results

FY2016 preview and first take on EU Council proposal for post-2020 EU-ETS reform.

The German utilities will present their FY2016 results in the coming days, and in this note, we preview earnings season with a look at the numbers we are expecting as well as the key issues we expect management to focus on. At the same time, we take a first look at the potential implications of the ambitious proposal for post-2020 reform of the EU-ETS approved by the EU Council last week. E.ON (OW; PT: €8.50) and Innogy (EW; PT: €33) have only very limited exposure to post-2020 EU carbon prices, but for RWE (EW; PT: €13.10) and Uniper (EW; PT: €14.30), the sensitivity is potentially very material. As a result, we think that if – as the legislation for post-2020 EU-ETS reform is finalized over coming months – the perception takes hold that the supply of European carbon allowances (known as EUAs) will tighten significantly post-2020, this could lead to a re-appraisal of the long-term equity stories of RWE and Uniper. Whatever the shape of the final post-2020 EU-ETS reform package, however, we expect EUA prices to remain weak in 2017 and 2018 owing to ongoing oversupply.

Carbon carnival: chimera or concrete? Last Tuesday, 28 February, as Carnival celebrations reached their climax all over Germany, the EU Council (i.e. member state governments) approved reforms to the EU-ETS that we think could significantly tighten the supply-demand balance in the EU carbon market post-2020 sooner than expected. Carnival is traditionally a time in which established social roles are suspended or reversed, and in this sense, the EU Council position agreed last Tuesday was in keeping with the carnival spirit: traditionally, the Council has been weaker on reforms to the EU-ETS than the EU Parliament, but on this occasion, the Council actually proved more ambitious. The role reversal came as a surprise to the market, and EUA prices rallied 13% the next day (appropriately enough, the first day of Lent, a period of scarcity), before giving back half of these gains the next two days. Beyond these coincidental timings, however, there now looms a big question: Will the post-2020 EU-ETS reform proposals approved by the EU Council last week be enough to reduce the significant surplus of EUAs so that meaningful price tension is re-established in the EU-ETS beyond 2020? Or, will this latest attempt at reform go the same way as previous efforts and prove inadequate to revive the market?

Outlook for post-2020 EUA prices now more bullish but still weak for 2017 and 2018.

Our first read on last week's EU Council position is that if the main elements of its proposal are accepted in the trilogue discussions that will now begin for the EU Council, the EU Parliament and the European Commission, the outlook for the post-2020 supply-demand balance in the EU-ETS would become much tighter, and hence, other things being equal, the outlook for post-2020 EUA prices more bullish. Thus, the trilogue negotiations have the potential to re-shape the perception of the long-term equity story for RWE and Uniper with RWE negatively exposed to higher long-term carbon prices, and Uniper more positively exposed. In our current valuations for RWE and Uniper, we assume a carbon price of only €6/tonne in real terms through 2030, but if the reform proposal is accepted, we think prices could reach €15/t by 2021-22 and €25-30/t by 2030. At this stage, however, we make no changes to our long-term carbon-price forecasts.

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PLEASE SEE ANALYST CERTIFICATION(S) AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 31.

EARNINGS PREVIEW

European Utilities

NEUTRAL

Unchanged

For a full list of our ratings, price target and earnings changes in this report, please see table on page 2.

European Utilities

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Summary of our Ratings, Price Targets and Earnings Changes in this Report (all changes are shown in bold)

Company	Rating		Price	Price Target			EPS FY1 (E)			EPS FY2 (E)		
	Old	New	03-Mar-17	Old	New	%Chg	Old	New	%Chg	Old	New	%Chg
European Utilities	Neu	Neu										
Uniper SE (UN01 GY / UN01.DE)	EW	EW	13.50	14.30	14.30	-	2.19	2.19	-	1.10	1.06	-4

Source: Barclays Research. Share prices and target prices are shown in the primary listing currency and EPS estimates are shown in the reporting currency.

FY1(E): Current fiscal year estimates by Barclays Research. FY2(E): Next fiscal year estimates by Barclays Research.

Stock Rating: OW: Overweight; EW: Equal Weight; UW: Underweight; RS: Rating Suspended

Industry View: Pos: Positive; Neu: Neutral; Neg: Negative

Valuation Methodology and Risks

European Utilities

RWE (RWE GY / RWE.GE)

Valuation Methodology: We value RWE on a SOTP basis. Our valuation is DCF based for European Generation assets with an asset-related WACC used depending on asset type and region. Trading is valued on an EV/EBITDA multiple basis, for Innogy we are using our fair value assumptions. For foreign currencies we use the average YTD rate weighted by the spot rate for the remainder of the year. We mark to market all wholesale commodity prices for the length of their liquid forward curves. Post this period we assume a modest clean dark spread recovery in Germany to €5/MWh in 2020 and €7/MWh in 2021 and beyond as we see the German power market tightening when Nuclear capacity comes offline and announced coal closures materialize (>8GW). For the UK we assume a modest £3/MWh clean spark spread. For capacity payments in the UK we assume £6.95/kW for 2017/18. For the years 2018/19 and 2019/20 prices are determined at £19.4/kW and £18/kW, respectively. The latest 8 December 2016 auction determined a £22.5/kW strike price for 2020/21. For 2021/2022 and 2022/23 we assume £30/kW and £25/kW from 2023/24 onwards.

Risks which May Impede the Achievement of the Barclays Research Valuation and Price Target: RWE is exposed to wholesale energy commodity prices, interest rates, regulatory and political intervention/risks, economic factors, corporate activity & competition

Uniper SE (UN01 GY / UN01.DE)

Valuation Methodology: We value Uniper on a SOTP basis. Our valuation is DCF based for European Generation assets with an asset-related WACC used depending on asset type and region. Global Commodities is valued on an EV/EBITDA multiple basis, using different multiples for Gas Midstream, Yushno Russoje, pipeline participations and power trading. Uniper's International business consists mainly of Unipro, a listed entity for which' valuation we are using the current market capitalisation of 100% (Uniper holds a 83.7% stake in the business, accounted for in minorities) with its Brazilian business valued at EV/EBITDA multiples. For foreign currencies we use the average YTD rate weighted by the spot rate for the remainder of the year. We mark to market all wholesale commodity prices for the length of their liquid forward curves. Post this period we assume a modest clean dark spread recovery in Germany to €5/MWh in 2020 and €7/MWh in 2021 and beyond as we see the German power market tightening when Nuclear capacity comes offline and announced coal closures materialize (>8GW). For the UK we assume a modest £3/MWh clean spark spread. For capacity payments in the UK we assume £6.95/kW for 2017/18. For the years 2018/19 and 2019/20 prices are determined at £19.4/kW and £18/kW, respectively. The latest 8 December 2016 auction determined a £22.5/kW strike price for 2020/21. For 2021/2022 and 2022/23 we assume £30/kW and £25/kW from 2023/24 onwards.

Risks which May Impede the Achievement of the Barclays Research Valuation and Price Target: Uniper is exposed to wholesale energy commodity prices, interest rates, regulatory and political intervention/risks, economic factors, corporate activity & competition.

Source: Barclays Research.

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INVESTMENT CASE SUMMARY

We summarize our investment case for the four German utilities below and then offer more detailed analysis of each in the respective company sections later in this report.

E.ON (OW; PT: €8.50)

EOAN GY / EONGn.DE

Stock Rating
OVERWEIGHT

Industry View
NEUTRAL

Price Target
EUR 8.50

Price (03-Mar-2017)
EUR 7.48

Potential Upside/Downside
+13.7%

E.ON looks attractive on a P/E basis and its dividend yield is competitive on our numbers: We think that E.ON's operating businesses and assets are generally viewed to be of high quality but that the two major (and related) curbs on investor appetite for the stock over the last 12 months have been (i) the uncertainty over a final nuclear settlement and (ii) the constraint the balance sheet has placed on E.ON's dividend-paying capacity. However, with (i) a nuclear deal agreed at the end of last year, (ii) the upgrades to consensus EPS that we see coming through in the next few weeks from applying a lower accretion rate to the residual nuclear provisions, and (iii) the Uniper stake worth 30% more than when spun off in September (and available to sell down in whole or in part from 2018), we see scope for sentiment to improve and E.ON's value to be re-appraised by the market. As a result, while we expect that retaining the BBB+ credit rating will remain a clear priority for E.ON, we see a dividend yield in line with sector peers while still allowing for the ND/EBITDA ratio to fall from 4.9x in 2017 to 4.1x in 2020.

E.ON – risks to thesis and valuation: The main downside risks are (i) possible capital measures to shore up the balance sheet (e.g. an accelerated book-build, hybrid issuance, and/or other measures) that would dilute existing shareholders' interests, and (ii) adverse interest-rate movements prompting an upward revision of pension and other provisions. The main upside risk is victory in the challenge to the NFT, which would be worth ~€3bn on a pretax basis (€1.5/share), or 0.6x off the ND/EBITDA ratio, thereby likely obviating the need for any capital measures.

Uniper (EW; PT: €14.30)

UN01 GY / UN01.DE

Stock Rating
EQUAL WEIGHT

Industry View
NEUTRAL

Price Target
EUR 14.30

Price (03-Mar-2017)
EUR 13.50

Potential Upside/Downside
+5.9%

Focused management but fairly valued for now: We remain EW on Uniper with an unchanged price target of €14.30 although we are yet to take account of the Group's sale of its stake in the Russian gas field Yuzhno-Russkoye, which was announced on 5 March.¹ We update our model to take account of the lower out-turn in the UK capacity payment for 2017-18 than we were previously assuming, and we also lower our assumptions for UK capacity payments for the years 2021/22 and beyond, while after a recent conversation with IR, we also now assume higher cash outflows over 2017-19 against provisions. Against that, we have revised down our number for pension provisions in our SOTP to take account of higher benchmark interest rates. The net impact of all these changes to our SOTP is value-neutral, but the higher cash outflow on provisions we are now assuming, combined with lower assumed strike prices for UK capacity payments, reduces our EPS estimates by an average of 4% over 2017-19. At the same time, the higher cash outflows on provisions we are now modelling also reduces the scope we see for Uniper's dividend, and our revised DPS forecasts over 2017-19 are now 7% lower on average over this period than previously. On our updated numbers, Uniper trades on forward P/E multiples of 12.7x for 2017 and 10.3x for 2018 vs. 13.2x and 12.6x for the average of Integrated and Generator utilities, respectively, and yields 4.3% for 2017 and 5.1% for 2018 compared with 5.1% and 5.4% for the average of Integrated and Generator utilities.

¹ See our First Look report of 6 March, *Sale of Yuzhno-Russkoye gas field supports mid-term strategy* for more details on the expected financial impact of this transaction. We will update our numbers for the impact of the Yuzhno-Russkoye disposal after the FY results on 9 March as this will be the natural opportunity for a full update of our numbers in any case.

Uniper – Risks to Thesis and Valuation: The main downside risks are the €2bn of targeted disposals by end-2017 (a risk to our earnings forecasts with added execution risk)² and a later start-up of Datteln-4 and re-start of Berezovskaya-3 than we assume. The main upside risks are higher German and UK power prices than we assume.

RWE (EW; PT: €13.10)

RWE GY / RWE.G.DE

Stock Rating

EQUAL WEIGHT

Industry View

NEUTRAL

Price Target

EUR 13.10

Price (03-Mar-2017)

EUR 14.01

Potential Upside/Downside

-6.5%

CMD keenly awaited while EU and German climate policy pose long-term risks: On our numbers, RWE trades on P/E multiples of 11.2x for 2017 and 12.4x for 2018 (vs. sector peers on 13.2x and 12.6x), making it one of the cheapest stocks in our universe on this metric. However, there is still a lot of uncertainty around the Group's future strategy and valuation, some of which relates to factors within management's control (the balance between dividends and capex) and some of which relates to factors beyond management's control (future German climate policy and the implications of this for RWE's lignite power-generation business). As explained in our report of 10 February, *RWE: Cash or carry?*, our numbers indicate that after taking into account the dividend from Innogy, RWE has scope to pay a higher dividend than the €0.5 it recently committed to for 2017 (and which will then serve as a floor for the following years). However, the question management must answer at the CMD is this: What is the long-term balance it wants to strike between (i) paying a generous dividend, (ii) having scope for some growth capex while setting aside funds for future liabilities, and (iii) preparing for what might be a materially tougher long-term future if the next German Government moves aggressively to implement the Climate Action Plan 2050 (CAP 2050) (which would be bearish for RWE's lignite and coal-fired generation)? Realistically, the first of these questions has already been answered with the new guidance on future dividend policy given on 22 February, but a DPS of €0.50 still implies a dividend yield of only 3.6% for 2017 and 2018 vs. peers at 5.1% and 5.4%, respectively, so management might wish to give clearer guidance for 2018 and beyond. As a result, the CMD on 28 March should provide the opportunity for management to clarify its future strategy on dividends and growth capex and to set out its plans for managing the risks associated with its lignite portfolio in the face of Germany's CAP 2050 plan.

RWE – risks to thesis and valuation: On a 12-month view, the main upside risks are that RWE wins its NFT appeal (worth €2.9/share) and that long-term coal and power prices move above the levels assumed in our base case. The main downside risk is that long-term coal and power prices move below the levels we assume in our base case. Beyond a 12-month horizon, the main risk is that the implementation of Germany's CAP 2050 plan leads to an accelerated reduction of lignite and hard coal in Germany's generation mix with bearish implications for RWE's conventional power business.

Innogy (EW; PT: €33)

IGY GY / IGY.DE

Stock Rating

EQUAL WEIGHT

Industry View

NEUTRAL

Price Target

EUR 33.00

Price (03-Mar-2017)

EUR 33.91

Potential Upside/Downside

-2.7%

Defensive growth but fairly valued: We like Innogy's defensive-growth profile and attractive dividend policy; we project an EPS CAGR over 2016-20 of 5.5% and an average payout ratio of 74%, implying a 2017 yield of 5.3%. The main growth driver is the Renewables business, and with our model assuming a fall in the leverage ratio from 4x as of year-end 2016 to 3.3x by 2020, there is scope for higher growth capex than we project. Innogy's defensive-growth profile is attractive, but at current levels, we think the shares look fairly valued relative to peers.

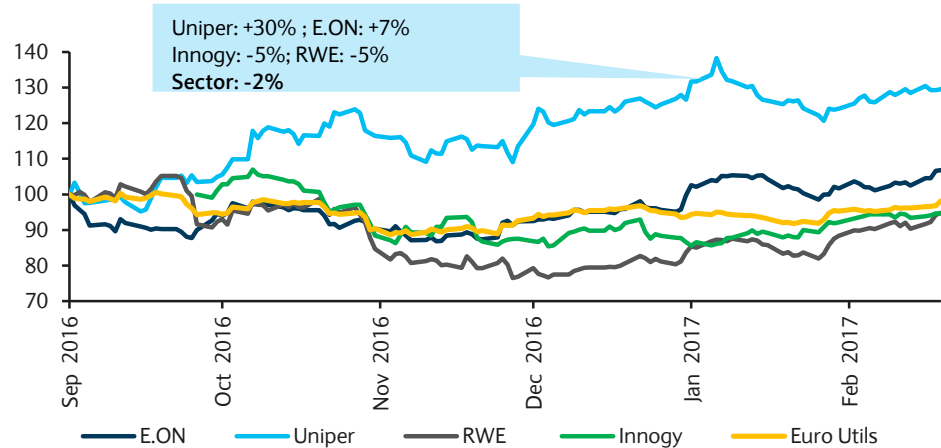
Innogy – risks to thesis and valuation: The main downside risks are a further depreciation of sterling vs. the euro and a slower rebound in the UK retail business than we assume. The main upside risk is faster growth in Renewables than we assume.

² Again, this is before the disposal of Yuzhno-Russkoye, which – as per our First Look report of 6 March, *Sale of Yuzhno-Russkoye gas field supports mid-term strategy* and hence before including it in our numbers – we estimate will result in a normalized full-year dilution to adjusted EPS of ~13%.

RECENT PERFORMANCE OF GERMAN UTILITIES

Figure 1 shows the performance of the German utilities since 12 September 2016 (the day of Uniper’s listing) with Innogy shown since 7 October (the day of its listing).

FIGURE 1
Relative performances of the German Utilities vs. the broader sector



Note: Graph shows relative performance of respective stocks since Uniper listing on 12 Sept 2016, except for Innogy, which only started trading on 7 Oct 2016. All rebased to respective dates. Source: Datastream

Uniper has been the best performer over this period, increasing by 30% in absolute terms since 12 September and outperforming the European utilities sector by 32% over this period (the sector is down by 2%).

The next best performer has been E.ON with an absolute increase of 7% and, hence, outperformance vs. the sector of 9%.

By contrast, both RWE and Innogy have fallen by 5% in absolute terms since 12 September and 7 October, respectively.

Our best idea among the Germans is E.ON for which we see 13% further upside.

CARBON CARNIVAL: CHIMERA OR CONCRETE?

In this section, we take a first look at the potential implications of the ambitious proposal for post-2020 reform of the EU-ETS that was approved by the EU Council last week.³ E.ON and Innogy have only very limited exposure to post-2020 EU carbon prices, but for RWE and Uniper, the sensitivity is potentially very material. As a result, we think that if, as the legislation for post-2020 EU-ETS reform is finalized over coming months, the perception takes hold that the supply of EUAs will tighten significantly post-2020, this could lead to a re-appraisal of the long-term equity stories of RWE and Uniper. Whatever the shape of the final post-2020 EU-ETS reform package, however, we expect EUA prices to remain weak in 2017 and 2018 owing to ongoing oversupply.

Reminder 1: Why EUA prices are so weak

Figure 2 shows the price for EU carbon allowances – technically known as European Allowances, or EUAs – since 2010. Today, EUAs trade at €5.6/t, or ~60% lower than six years ago. So, what explains this persistent price weakness?

FIGURE 2
EUA prices, January 2010-to date (€/tonne)



Source: Bloomberg

As we have indicated in our previous reports (see, for example, *German Utilities: Two degrees (2°C) of separation*, 7 March 2016, and *German Utilities: Scoping the 'Tragedy of the Horizon'*, 1 September, 2016), the essential problem with the EU-ETS is that the scheme is significantly oversupplied with estimates for the total surplus by 2020 ranging between 2,600m and 4,000m EUAs. Reducing this surplus to a level at which price tension can be re-established – which in our view would need to be no more than 1,000m – would likely take until the late 2020s under the European Commission's original proposals for post-2020 reform of the EU-ETS, and it is in this context that that last week's vote in the EU Council is potentially so significant. This is because the Council position on EU-ETS reform offers the prospect of tightening the supply of EUAs beyond 2020 much more significantly than originally foreseen by the Commission as well as by more than foreseen by the Parliament.

Before we look at the Council's proposal in more detail, however, let us remind ourselves why EUA prices matter to power generators.

³ Note that our analysis below assumes a constant perimeter for the EU-ETS from 2021 onwards, i.e. that the UK remains in the EU-ETS after Brexit takes effect.

Reminder 2: Why EUA prices matter for German generators

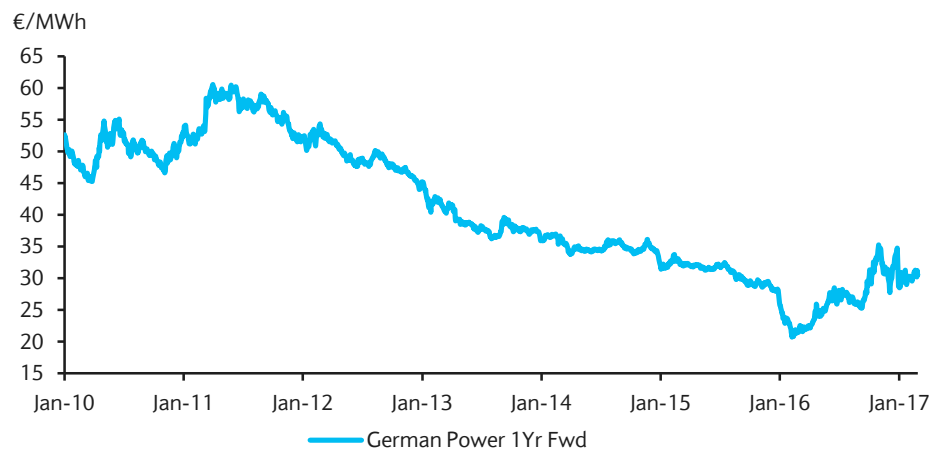
Carbon prices matter to power generators for two reasons:

1. **The carbon price contributes to the absolute level of wholesale power prices:** As a commodity-price input (just like coal, lignite, and gas), the price of EUAs has a direct impact on the cost of generating for all fossil-fuel (FF) generators. As such, as FF generation remains an important element in the generation mix for most EU countries – and, in particular, as FF plants are the price-setting generators much of the time across EU markets – the EUA price has a direct impact on the wholesale power price with the impact depending on (i) how carbon-intensive the price-setting FF plant is and (ii) how much of the time the price is being set by FF plant. This means that the less carbon-intensive a given generator, the more it will benefit from higher carbon prices, as the selling price of its electricity will increase by more than its cost inputs. For hydro and nuclear generators, for example, any increase in power prices resulting from higher carbon prices represents pure margin, while gas generators benefit proportionately more from a carbon-fuelled increase in power prices than do coal generators (gas is much less carbon-intensive than coal).

Figure 3 shows the trend in one-year forward German baseload prices since January 2010. As of 6 March, the price is down 42% vs. January 2010. The drop in power prices over this period is a function of two main factors, namely (i) the increase in the share of renewable output in Germany over this period and (ii) the drop in commodity prices over this period, including the price of EUAs (note that although power prices have fallen by less than EUAs since 2010, the evolution of the power price shown in Figure 3 is very similar to the evolution of the carbon price shown in Figure 2 above).

FIGURE 3

1-year forward German baseload prices, January 2010-to date (€/MWh)



Source: Bloomberg

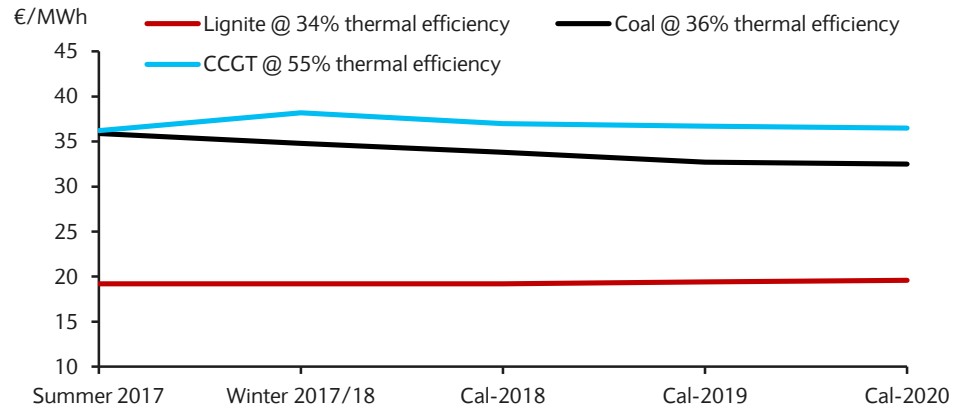
2. **The carbon price determines the relative competitiveness of FF generators:** The carbon price determines the merit order for FF generators – i.e. the order in which they are dispatched to meet demand – based on their carbon intensity. Other things being equal, low carbon prices therefore benefit carbon-intensive FF generators (i.e. those that burn lignite and coal) and high carbon prices benefit less carbon-intensive FF generators (i.e. those that burn gas).⁴

⁴ The thermal efficiency of a given plant will also be an important element in the relative competitiveness – highly efficient lignite and coal plants can still be more competitive than old, inefficient gas plants even if carbon prices are high – but the carbon intensity of the fuel itself is crucial to determining the merit order for FF generators.

Figure 4 shows the short-run marginal cost (SRMC) for German FF generators out to 2020 using the current forward curves for coal, gas and EUAs as well as an assumed fuel cost for lignite of €12/t. We assume an efficiency rate of 34% for lignite (an old, inefficient plant), 36% for coal (an average efficiency plant) and 55% for gas (a newer, more efficient plant).

FIGURE 4

German merit order among fossil-fuel generators, 2017-20



Source: Bloomberg, Barclays Research

As can be seen, at the moment the lignite plant has by far the lowest SRMC, and while coal and gas are bunched more closely together, coal remains more competitive than gas on the basis of the current forward curves for coal, gas and EUAs.

In short, low carbon prices are contributing both to low power prices and to the paradoxical situation whereby old, inefficient lignite plants are significantly more competitive than relatively new, efficient gas plants even though the EU has long claimed global leadership on the issue of climate change and reducing emissions.

What happened in the EU Council last week?

Last Wednesday, 1 March, the day after the EU council agreed an ambitious position on post-2020 EU-ETS reform for final negotiations with the EU Parliament and the European Commission, EUA prices rallied 13%. The reason for this was that the EU Council (i.e. member state governments) approved reforms to the EU-ETS that we think could significantly tighten the supply-demand balance in the EU carbon market post-2020 much sooner than previously expected.

As the Council agreed with both the Commission and the Parliament that the annual linear-reduction factor (LRF) at which the cap should decline over Phase-4 of the EU-ETS (2021-30) should be 2.2%, the key changes recommended by the Council last week relate (i) to the annual rate at which the MSR takes out EUAs from the market to reduce the EUA surplus⁵ and (ii) to the Council's proposal to cancel a much larger number of EUAs from the MSR than the Parliament suggested when it agreed its position on the reform on 15 February (this is important from a signalling rather than a pricing point of view).⁶

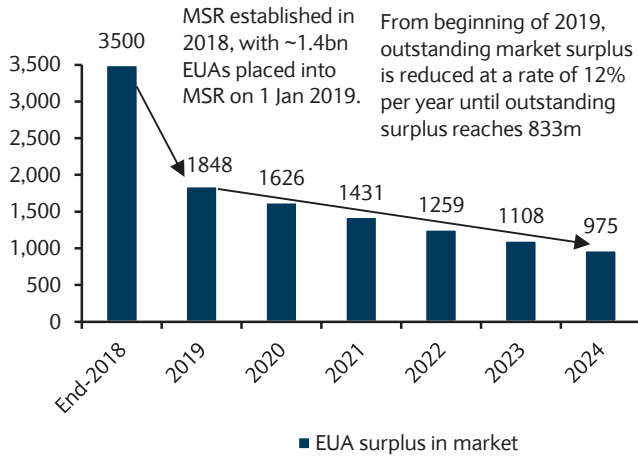
Figure 5 shows our stylized analysis of the Commission's original proposal for reducing the massive surplus in EUAs, and Figure 6 our stylized analysis of how the Council's proposed amendments to the Commission's proposal would reduce the surplus more quickly.

⁵ As explained below, the Commission originally proposed an annual reduction in the surplus of 12% from 2019, whereas both the Parliament and the Council have proposed this be tightened to 24% (the Parliament for the first four years of the MSR's life, and the Council for the first five years).

⁶ The Commission's proposal made no mention of cancelling EUAs in the MSR, while the Parliament's position is to cancel 800m EUAs as a one-off measure in 2021, and the Council's position as per our stylized analysis below implies cancelling ~1.9bn in 2024 and thereafter capping the level of the MSR at the level of the annual auctioned amount.

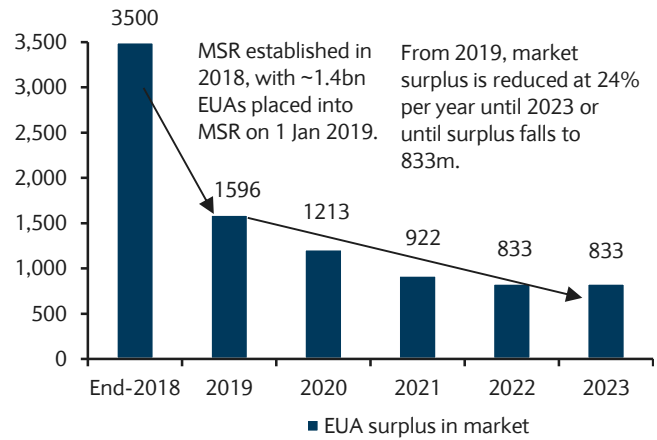
The key assumption we make is that the accumulated surplus of EUAs in the market will stand at 3.5bn by end-2018, which is towards the upper end of the range of market estimates *based on comparisons we have seen on the European Commission’s website*. We maintain all other variables constant in our comparative analysis of the Commission’s and Council’s proposals for dealing with this surplus, focusing here exclusively on the measures designed to eradicate the existing surplus.⁷

FIGURE 5
Stylized analysis of impact of MSR on outstanding EUA surplus under European Commission’s proposal for post-2020 EU-ETS reform (EUA m)



Source: European Commission, Barclays Research estimates

FIGURE 6
Stylized analysis of impact of MSR on outstanding EUA surplus under EU Council’s proposal for post-2020 EU-ETS reform (EUA m)



Source: Source: EU Council, Barclays Research estimates

As per Figure 5, under the Commission’s proposal the MSR is established in 2018 and starts functioning from 2019. We assume 1.4bn EUAs are placed in the MSR from day one (the 900m back-loaded EUAs from Phase-3, plus ~500m of unused Phase-3 allowances), and that the residual surplus is then taken out at 12% per year until the surplus drops to 833m. At 833m, the MSR would then cease to take out any more of the surplus. If the surplus then declined further over time such that it dropped to 400m, the Commission would start to release EUAs back into the market at a rate of 100m per year until the MSR was exhausted.

On the basis of our stylized analysis of the Commission’s original proposal, then, the outstanding EUA surplus would still be above 833m by 2024 (975m as per Figure 5), and would not reach 833m until 2026.⁸

By contrast, the Council’s proposal is much more ambitious. As per Figure 6, the starting point for the MSR from the beginning of 2019 is the same as under the Commission’s proposals – i.e. on our assumption ~1.4bn EUAs would be placed in the MSR from day one – but thereafter the residual surplus is reduced at a rate of 24% per year for five years or until the outstanding surplus is reduced to 833m.

Under the Council’s proposals, and under our stylized analysis, we calculate that the outstanding surplus would fall to 833m already in 2022, compared with 2026 under the Commission’s proposal, i.e. four years earlier.

⁷ In reality, of course, the surplus is a dynamic variable that will increase or decrease over time as a function of a number of variables, not just the rate at which the surplus existing at the beginning of 2019 is removed (these other factors relate to the demand for EUAs annually from 2020 on the part of FF generators, i.e. the factors that determine the amount and breakdown of FF output, e.g. the availability of renewable- and nuclear-generating capacity, the impact of energy-efficiency measures, and the relative fuel-input costs for the coal and gas-fired generators).

⁸ On the Commission’s proposal, after reaching 833m, the MSR would cease to take any further action until either (i) the outstanding surplus started to increase to a level above 833m again, or (ii) the surplus declined to a level below 400m, at which point the MSR would start releasing EUAs back into the market at 100m per year until exhausted.

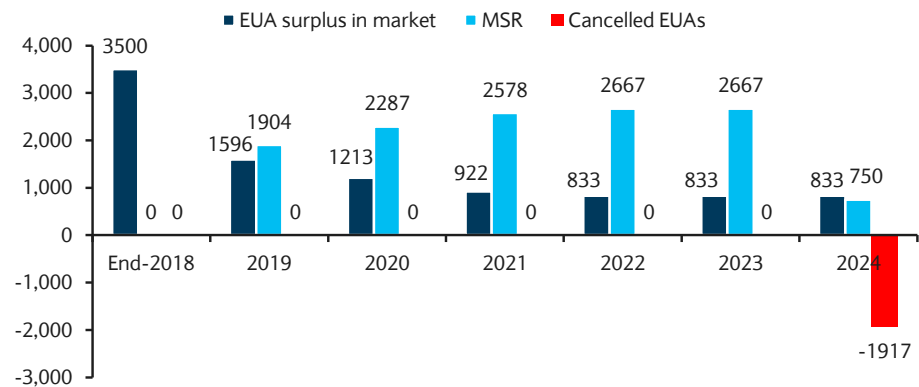
Moreover, from 2024 onwards, the Council's proposal foresees the cancellation of the difference between the number of EUAs in the MSR on the one hand and the amount of EUAs offered for annual auction on the other.

As shown in Figure 7, on the basis of our stylized analysis, the total amount of EUAs in the MSR by the end of 2023 under the Council's proposal would reach ~2.7bn, and we estimate the annual amount of EUAs to be auctioned over 2021-30 at 750m.

On this basis, therefore, the Council proposal would imply the cancellation of ~1.9bn EUAs in 2024 and would cap the amount of EUAs in the MSR thereafter at ~750m.

FIGURE 7

Estimate of development of EUA market surplus and amount of EUAs in MSR under EU Council proposal, 2019-2023 (m), and of number of EUAs cancelled in 2024 (m)



Source: Barclays Research

In short, we estimate that other things being equal, the outstanding EUA surplus would fall much more quickly under the Council's proposal than under the Commission's proposal, with the proposed cancellation of ~1.9bn EUAs in 2024 adding an important extra signalling dimension⁹ and capping the amount of EUAs in the MSR from 2024 onwards at the level of annual auctions (~750m on our estimates).

The big question is: What would the pricing impact of the Council's proposal be?

What is the potential pricing impact for EUAs post-2020?

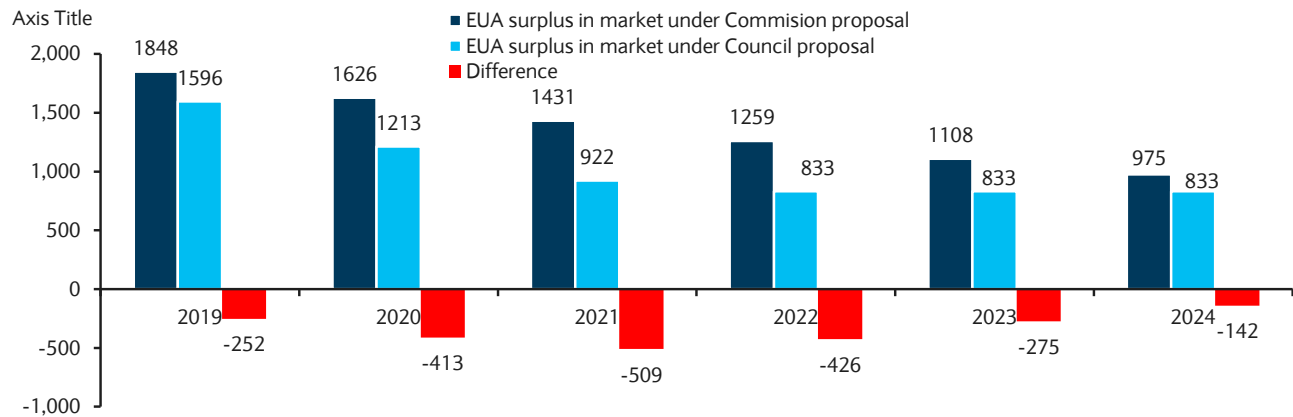
As just shown above, our stylized analysis indicates that under the EU Council proposal the post-2020 supply-demand balance in the EU-ETS would tighten much sooner than under that of the Commission.

In turn, this implies a more bullish pricing outlook under the Council's proposal than under that of the Commission.

Figure 8 shows the difference in the outstanding market surplus between the Commission's proposal and the Council's proposal over 2019-24.

⁹ We think the signal that cancelling ~1.9bn EUAs in 2024 would send is bullish, even though the pricing impact of any such cancellation would likely not be felt until after 2030. We say this because in terms of pricing, what matters is whether the EUAs are available to the market or not, and under both the Commission's and the Parliament's proposals EUAs in the MSR would not in any case be released to the market until the outstanding EUA surplus dropped below 400m (we think that this would likely not happen until 2030 or later under the Commission's proposal). However, if ultimately accepted in the final trilogue position to be agreed in the coming months, signaling an intention already in 2017 to cancel such a large amount of EUAs from the MSR would set a radical precedent, and could make it easier for further cancellations to be proposed at a later date. In other words, once the principle of such large-scale cancellation were accepted, we think it would change the market's perception of how radically the EU bodies might act in the future if the current reform package were to fail in re-establishing price tension.

FIGURE 8

Barclays estimate of difference in EUA market surplus between Commission's original proposal and EU Council's proposal

Source: European Commission, EU Council, Barclays Research estimates

As can be seen, under the Council's proposal, the market would be ~500m shorter by 2021 compared with the Commission's original proposal with a total surplus of 922m vs. 1.4bn under the Commission's proposal.

This is below the key surplus level of 1,000m at which we think meaningful price tension would start to be re-established as power generators hedge their output forward and hence need allowances from today's surplus to hedge future output. We estimate that the combined forward hedging demand for EUAs on a rolling three-year basis by the early 2020s will be in the order of 900m-1,000m EUAs.

In our view, this suggests that if the Council's proposed reforms of the EU-ETS are ultimately accepted as the final position agreed by the Council, Parliament and Commission under the trilogue negotiations, meaningful price tension – by which we mean prices of €15/t or more – could be achieved by the early 2020s instead of the late 2020s (or even later) under the Commission's original proposal.

We derive these numbers from looking at the EUA price required to push the most efficient gas plant ahead of the average coal plant on current forward coal and gas prices (this is what would need to happen by 2021-22 if the three-year rolling hedging requirement for EU generators were greater than the surplus of 922m in 2021 as shown in Figure 8 above).

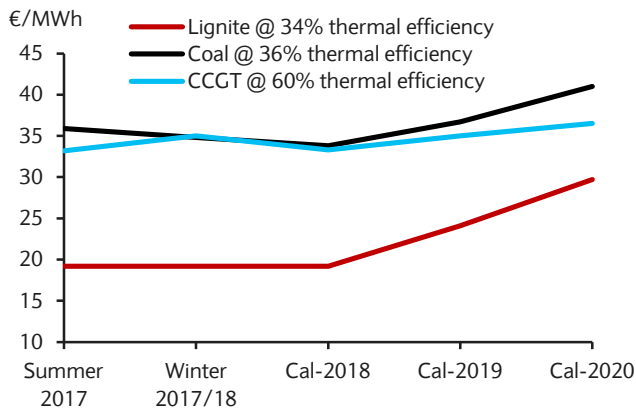
As the forward curve only goes out as far as 2020, Figure 9 takes the current forward prices for coal and gas in 2019 and 2020, but for our stylized purposes here assumes a carbon price of €10/t in 2019 and €15/t in 2020.

As can be seen, if we assume the most efficient CCGT plants in Germany at the moment (those with a thermal efficiency of 60%), then at a carbon price of €10/t the CCGT plant would already be more competitive than a coal plant at 36% efficiency, and at a price of €15/t this gap would widen.

So, assuming the same coal and gas prices in 2021 and 2022 as are currently shown in the forward curve for 2019 and 2020 and assuming a market surplus of ~900m EUAs were not sufficient to satisfy the rolling three-year hedging demand of EU generators, then at that point in time abatement via fuel switching would be required, implying an EUA price by 2021-22 of €10-15/t.

FIGURE 9

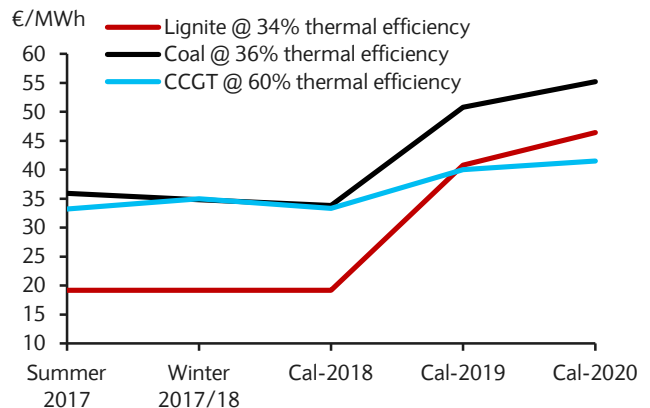
Hypothetical scenario: how the German FF merit order would look with EUAs at €10/t in 2019 and €15/t in €2020



Source: Bloomberg, Barclays Research

FIGURE 10

Hypothetical scenario: how the German FF merit order would look with EUAs at €25/t in 2019 and €30/t in €2020



Source: Bloomberg, Barclays Research

If the market surplus were lower still by the late 2020s, and the hedging requirement were such that the most efficient gas plant would have to displace lignite, then using the same methodology shown in Figure 9, our calculations shown in Figure 10 would suggest that an EUA price of €25-30/t would be required.

Implications for the German generators

In our current valuations for RWE and Uniper, we assume an EUA price of only €6/tonne in real terms all the way out to 2030, but if the Council’s proposal were ultimately accepted, we think prices could reach €15/t already by the early 2020s and potentially €25-30/t by 2030.

In our view, therefore, the trilogue negotiations that will now begin to have the potential to re-shape the perception of the long-term equity story for RWE and Uniper, with RWE negatively exposed to higher long-term carbon prices, and Uniper, in our view, more positively exposed. This is because if the Council’s proposals are ultimately accepted in the final trilogue position agreed between the Council, Parliament and Commission, market expectations about EUA prices post-2020 could increase significantly.

We are not making any changes to the carbon prices that we assume in our models for RWE and Uniper at this stage, but we will track the trilogue negotiation process closely to see where the final shape of the post-2020 EU-ETS comes out and then re-visit our assumptions accordingly at the appropriate time.

When will we know the final shape of the post-2020 EU-ETS?

Formal negotiations between the Council, Parliament and Commission can now begin with a view to agreeing a final common position and passing the final legislation. We expect this trilogue negotiations to be a relatively smooth process by EU standards, and for legislation to be passed later this year, perhaps even before the summer. Whether all of the Council’s proposals are adopted or not, we think that increasing the take-out rate of the surplus to 24% from 12% will be the final agreed position as this already has the support of the Parliament (albeit with Parliament proposing that the 24% takeout rate apply until the end of 2022 rather than the end of 2023 as proposed by the Council).

EUROPEAN UTILITIES VALUATION SHEET

Company	Cry	Rec	Price			TSR	Mkt Cap	Free Float	P/E			EV/EBITDA			EV/NOPAT			Div. Yield			FCF. Yield		
			Current	Target	+/-				2016E	2017E	2018E	2016E	2017E	2018E	2016E	2017E	2018E	2016E	2017E	2018E	2016E	2017E	2018E
Integrated Utilities & Generators																							
Centrica	£/p	EW	228	245	8%	13%	12.5	89%	13.7x	13.8x	12.5x	7.3x	7.3x	6.9x	17.2x	16.7x	15.1x	5.4%	5.5%	5.6%	11.3%	8.3%	11.3%
CEZ *	CZK	-	454	-	-	-	246.3	30%	13.1x	16.3x	17.0x	6.1x	6.6x	6.7x	15.8x	19.2x	20.3x	6.6%	5.3%	4.7%	-	-	-
Drax	£/p	EW	349	400	14%	15%	1.4	95%	nm	nm	17.7x	4.7x	4.5x	4.0x	nm	11.0x	7.7x	0.6%	2.0%	4.4%	5.3%	16.7%	14.5%
EDF	Eur	OW	9.7	12.5	29%	39%	20.2	23%	5.5x	10.7x	11.2x	6.3x	7.5x	7.6x	9.4x	11.1x	11.3x	9.7%	4.5%	4.5%	-6.9%	-9.5%	-8.9%
EDP *	Eur	-	2.8	-	-	-	10.7	69%	11.0x	10.7x	10.6x	8.3x	8.2x	8.1x	18.5x	18.2x	17.8x	6.8%	6.8%	6.9%	-	-	-
Endesa *	Eur	-	20.1	-	-	-	21.3	30%	15.4x	15.9x	16.4x	6.5x	6.5x	6.4x	15.3x	15.8x	15.4x	6.5%	6.4%	6.4%	-	-	-
ENEL	Eur	OW	4.1	5.00	21%	25%	41.9	71%	13.0x	12.1x	10.6x	7.1x	7.0x	6.6x	17.6x	16.3x	15.1x	4.4%	4.9%	6.1%	4.4%	6.1%	7.7%
E.ON	Eur	OW	7.51	8.5	13%	15%	14.9	94%	17.8x	10.4x	10.4x	8.4x	8.6x	8.6x	18.9x	19.3x	19.8x	2.2%	4.8%	4.8%	-2.2%	-24.7%	1.1%
EVN *	Eur	-	12	-	-	-	2.1	17%	12.6x	12.0x	12.7x	6.5x	6.4x	6.5x	18.7x	18.2x	13.6x	3.5%	3.6%	4.0%	-	-	-
Fortum*	Eur	-	15.0	-	-	-	13.3	49%	23.4x	21.6x	20.7x	9.6x	8.9x	8.6x	18.3x	16.5x	16.2x	4.6%	4.4%	4.4%	-	-	-
Gas Natural *	Eur	-	19	-	-	-	18.6	36%	14.0x	13.7x	12.9x	7.2x	7.1x	6.8x	16.5x	16.1x	15.5x	5.4%	5.4%	5.6%	-	-	-
Engie *	Eur	-	12.8	-	-	-	30.7	71%	12.6x	13.0x	12.2x	6.3x	6.4x	6.3x	15.8x	16.2x	15.7x	7.8%	5.6%	5.5%	-	-	-
Iberdrola *	Eur	-	6	-	-	-	40.7	90%	15.3x	14.8x	14.1x	8.6x	8.4x	8.0x	20.2x	19.7x	18.7x	4.7%	4.8%	5.1%	-	-	-
Innogy	Eur	EW	31.3	33.0	5%	11%	19.0	23%	15.4x	13.6x	13.0x	9.1x	8.7x	8.3x	19.6x	18.3x	17.4x	5.2%	5.4%	5.6%	4.1%	7.8%	9.4%
PPC *	Eur	-	3	-	-	-	0.7	49%	6.8x	7.8x	6.2x	5.4x	5.7x	5.2x	14.7x	23.8x	12.4x	4.0%	3.3%	4.7%	-	-	-
RWE	Eur	EW	14.0	13.1	-6%	-4%	8.0	86%	13.9x	11.2x	12.4x	7.5x	8.1x	8.3x	18.7x	19.6x	19.8x	1.8%	1.8%	1.8%	30.6%	-33.2%	22.8%
SSE	£/p	OW	1539	1695	10%	16%	15.6	77%	12.6x	12.2x	10.8x	9.9x	10.0x	9.2x	16.4x	16.5x	14.9x	6.0%	6.1%	6.3%	3.5%	3.3%	5.4%
Verbund*	Eur	-	16.2	-	-	-	2.8	24%	18.6x	21.5x	24.0x	9.0x	9.9x	10.5x	20.2x	24.8x	27.1x	1.7%	1.4%	1.4%	-	-	-
Uniper	Eur	EW	13.5	14.3	6%	10%	4.9	53%	6.2x	12.7x	10.3x	6.3x	4.5x	6.1x	15.0x	13.7x	16.6x	4.1%	4.3%	5.1%	31.8%	1.5%	13.4%
Integr & Gen. Average									13.9x	13.2x	12.6x	7.7x	7.7x	7.5x	17.4x	17.3x	16.6x	5.1%	5.1%	5.4%	-	-	-
Integrated Utilities Average									14.0x	12.9x	12.2x	7.8x	7.8x	7.5x	18.0x	17.7x	17.0x	5.0%	5.1%	5.4%	-	-	-
Generators Average									16.0x	14.9x	19.9x	8.1x	7.6x	7.2x	12.7x	15.1x	14.0x	3.3%	3.5%	4.3%	-	-	-
Regulated Utilities																							
Enagas	Eur	UW	23.5	21.90	-7%	-1%	5.6	95%	13.3x	13.0x	13.4x	12.1x	11.2x	11.4x	23.7x	22.3x	23.1x	5.9%	6.2%	6.5%	9.8%	8.5%	8.8%
Pennon	£/p	UW	878	730	-17%	-13%	3.6	92%	19.8x	18.8x	17.1x	13.9x	13.8x	13.2x	27.1x	26.4x	24.7x	4.1%	4.3%	4.6%	0.2%	1.3%	4.4%
Red Electrica	Eur	UW	17.4	16.6	-4%	1%	9.4	80%	14.6x	13.6x	12.9x	10.3x	9.8x	9.5x	20.4x	19.1x	18.4x	4.9%	5.3%	5.7%	4.3%	7.2%	5.6%
REN	Eur	OW	2.64	3.10	18%	24%	1.4	30%	14.8x	12.2x	11.4x	8.4x	8.0x	7.8x	21.4x	19.9x	19.4x	6.5%	6.6%	6.7%	9.4%	10.5%	11.2%
Snam ReteGas	Eur	OW	3.9	4.6	19%	24%	13.5	69%	16.9x	15.2x	14.8x	12.6x	12.5x	12.3x	26.3x	25.2x	25.1x	5.4%	5.6%	5.7%	3.8%	5.0%	5.5%
Italgas	Eur	OW	3.83	4.00	4%	10%	3.1	60%	12.9x	11.4x	11.4x	10.9x	10.3x	10.1x	28.7x	25.1x	25.1x	5.2%	5.4%	5.5%	2.3%	6.2%	6.5%
Terna	Eur	OW	4.5	4.9	10%	15%	6.7	95%	15.4x	14.4x	14.0x	11.5x	11.1x	10.8x	27.2x	26.5x	24.3x	4.6%	4.8%	4.9%	1.3%	0.0%	6.9%
United Utilities	£/p	EW	982	900	-8%	-4%	6.7	95%	21.4x	21.2x	19.1x	13.5x	13.1x	12.7x	27.5x	26.2x	25.0x	4.0%	4.0%	4.2%	3.1%	3.8%	5.3%
Regulated Utilities Average									17.0x	15.8x	15.2x	11.6x	11.3x	11.1x	22.9x	21.6x	20.9x	4.8%	4.9%	5.1%	3.8%	4.6%	5.8%
Environmental																							
Seche Environnement *	Eur	-	13.89	-	-	-	0.2	34%	6.5x	6.0x	5.6x	5.6x	5.4x	5.2x	21.0x	19.7x	18.7x	6.8%	7.2%	7.6%	-	-	-
Suez	Eur	EW	16.3	14.5	-11%	-7%	7.9	68%	19.3x	15.7x	14.9x	7.3x	7.1x	6.9x	17.5x	17.3x	16.7x	4.0%	4.0%	4.0%	10.4%	10.9%	10.6%
Veolia	Eur	OW	16	19	19%	24%	9.1	100%	14.6x	13.3x	12.3x	6.8x	6.7x	6.5x	17.3x	16.4x	15.6x	4.9%	5.4%	6.0%	6.9%	9.2%	10.7%
Env. Serv. Average									14.6x	13.3x	12.3x	6.8x	6.7x	6.5x	17.4x	16.4x	15.7x	4.9%	5.4%	6.0%	-	-	-
Sector/Market																							
SX6P			375	-	-	-	-	-	13.7x	12.9x	12.3x	-	-	-	-	-	-	5.1%	5.4%	5.6%	-	-	-
Stoxx 600			376	-	-	-	-	-	15.1x	13.8x	12.6x	-	-	-	-	-	-	3.6%	3.8%	4.2%	-	-	-

Notes: Priced as of close 3 March 2017.

*Indicates non-covered stocks; all data for these companies are from Bloomberg consensus forecasts.

SSE, UU, and Pennon P/E multiples are shown post-deferred taxes. EV/EBITDA for RWE and E.ON includes associates.

Source: Company data, Bloomberg, Thomson Reuters, Barclays Research estimates

E.ON (OW; PT: €8.50): FOCUS ON OUTLOOK FOR CAPEX AND DIVIDENDS

FY 2016 results to be published 15 March

EOAN.GY / EONGN.DE

Stock Rating
OVERWEIGHTIndustry View
NEUTRALPrice Target
EUR 8.50Price (03-Mar-2017)
EUR 7.48Potential Upside/Downside
+13.7%

E.ON will publish its FY2016 results on Wednesday, 15 March, at 7.30 a.m. CET with a presentation by CEO Johannes Teysen and CFO Marc Spieker to follow at 1 p.m. CET. Figure 4 shows our preview for the Group's results vs. consensus (where available).

We are at the upper end of guidance for EBITDA and EBIT: E.ON's guidance for FY EBITDA is €4.6-5bn and for EBIT is €2.7-3.1bn, and our forecasts are at the upper end of these ranges and just slightly ahead of consensus in both cases, at €4.96bn and €3.068bn, respectively. We expect EBIT to decline ~14% year-on-year, driven by the negative 'photo-year' effect in the German network business and margin pressures in the German retail business. Lower (hedged) outright power prices as well as lower volumes are weighing on E.ON's nuclear operations, but we expect the renewable business to see an uplift year-on-year on the back of new offshore wind capacity (although we expect negative FX movements and lower wind yields to temper this somewhat).

We are in the middle of the range for Adjusted Net Income: We forecast Adjusted Net Income of €822m, down 25% year-on-year, just under consensus of €832m, and in the middle of E.ON's guidance range of €0.6-1bn.

FIGURE 11

E.ON – Barclays Research estimates for FY 2016 results vs. 2015 and consensus (where available)

€m	FY15A	FY16E	YoY	Cons.	Barclays vs. Cons.	Drivers Y/Y
Energy Networks	1,811	1,677	(7%)			
Germany	1,128	942	(17%)	-	-	(-) Photo year effect/pos. Prior year effect from provision release
Sweden	329	378	15%	-	-	(+) Re-regulation effect/2015 burdened by Storm costs
CEE & Turkey	354	358	1%	-	-	(+) Higher returns in Czech, Turkey and lower costs in Slovakia; (-) milder winter in Romania
Customer Solutions	806	774	(4%)			
Germany	397	286	(28%)	-	-	(-) Margin pressure/pos. one-off effects from provision release in 2015
UK	278	324	17%	-	-	(+) Lower ECO spending; (-) weak sterling
Other	131	164	25%	-	-	(+) Colder Winter in Sweden/lower gas procurement costs in East
Renewables	391	441	13%			(+) Contribution of new capacity in offshore wind/book gain Arkona; (-) weak sterling/lower overall prices/book gains in 2015/low wind yields
Corporate Functions/Other	(45)	(265)	489%			(-) Spin-off costs; (+) UK E&P partially in 2016
Preussen Elektra	600	440	(27%)			(-) Lower volumes, lower prices; (+) lower nuclear fuel tax
Adjusted EBIT	3,563	3,068	(14%)	3,046	1%	
Adjusted EBITDA	5,844	4,959	(15%)	4,895	1%	
Depreciation/ Amortisation	(2,281)	(1,892)	(17%)	(1,849)	2%	
Adjusted EBIT	3,563	3,068	(14%)	3,046	1%	
Economic interest expense (net)	(1,485)	(1,516)	2%	-	-	(-) Uniper financing impact/interest accretion on higher provisions
PBT (adj)	2,078	1,551	(25%)	1,631	-	
Tax (adj)	(710)	(503)	(29%)	-	-	
Minority Interests	(270)	(226)	(16%)	-	-	(+) In line with profit evolution German networks
Adjusted Net Income	1,098	822	(25%)	832	(1%)	
EPS - Recurrent	-	0.42	-	0.43	(1%)	
DPS	-	0.17	-	0.20	(16%)	
Economic Net Debt	(21,340)	(23,440)	10%	n/a	-	(-) Higher provisions for Nuclear and pensions
ND/EBITDA	3.7x	4.7x				
NOSH	1,933	1,952				
Effective tax rate (%)	34.2%	32.4%				

Source: Company information, Bloomberg consensus forecasts, Barclays Research estimates

What else to expect from the results? We expect a standard update on the dividend for 2016 as well as 2017 guidance on EBIT, EBITDA and net Income level. Further we expect a detailed update on their E.ON Focus model¹⁰, including 1) the impact of the deconsolidation of nuclear provisions on EPS, DPS and net debt; 2) E.ON's expectations regarding the timing of the Constitutional Court's ruling on the Nuclear Fuel Tax (NFT) and whether any capital measures would be necessary if the Group were to win its legal challenge; 3) how the nuclear-funding premium will be financed if E.ON were not to win the NFT case, and what other capital measures management thinks might be necessary above and beyond covering the nuclear-funding premium if E.ON were not to win the NFT case.

Focus on outlook for capex and dividends: As explained in our report of 18 January (*German Utilities: E.ON and Uniper: Power switch*), with the EPS upgrades we expect to see coming through as the market updates for changes to the accretion rate applied to the nuclear-decommissioning provisions going forward, we are positive on E.ON and see scope for a re-rating as uncertainty around the nuclear issue finally clears by the middle of this year. That said, and as we also acknowledged in our report of 18 January that we recognize that the leverage ratio remains an issue and that there is a clear risk of a need for capital measures to shore up the balance sheet if the Group does not win its legal challenge against the NFT. As a result, and assuming that the NFT verdict is still not known by 15 March, we expect the new CFO, Marc Spieker, to reiterate the focus on capex discipline.

We see a value story with 14% upside to our PT

E.ON looks attractive on a P/E basis and its dividend yield is competitive on our numbers: We think that E.ON's operating businesses and assets are generally viewed to be of high quality, but that the two major (and related) curbs on investor appetite for the stock over the last 12 months have been (i) the uncertainty over a final nuclear settlement and (ii) the constraint the balance sheet has placed on E.ON's dividend-paying capacity. However, with (i) a nuclear deal agreed at the end of last year, (ii) the upgrades to consensus EPS that we see coming through in the next few weeks from applying a lower accretion rate to the residual nuclear provisions and (iii) the Uniper stake worth 30% more than when spun off in September (and available to sell down in whole or in part from 2018), we see scope for sentiment to improve and E.ON's value to be re-appraised by the market.

As a result, while we expect that retaining the BBB+ credit rating will remain a clear priority for E.ON, we see a dividend yield in line with sector peers while still allowing for the ND/EBITDA ratio to fall from 4.9x in 2017 to 4.1x in 2020.

E.ON looks attractive on a P/E basis, and dividend yield is competitive: On our numbers, E.ON trades on forward P/E multiples of 10.4x for 2017E and 2018E, a significant discount to both integrated utilities (12.9x and 12.2x respectively) and network utilities (15.8x and 15.2x). With its prospective dividend yield of 4.8% for both 2017 and 2018, E.ON is also now competitive with sector peers on this key metric (regulated utilities offer 5.1% and 5.4% respectively), having previously offered a much lower yield than its sector peers.

Risks to thesis and valuation: The main downside risks are (i) possible capital measures to shore up the balance sheet (e.g. an accelerated book-build, hybrid issuance, and/or other measures) that would dilute existing shareholders' interests, and (ii) adverse interest-rate movements prompting an upward revision of pension and other provisions. The main upside risk is victory in the challenge to the NFT, which would be worth ~€3bn on a pre-tax basis (€1.5/share), or 0.6x off the ND/EBITDA ratio, thereby likely obviating the need for any capital measures.

¹⁰ The latest E.ON focus as presented first at its CMD in 2016 for the 'mid-term' includes a stable BBB+/Baa1 credit rating, stable Group EBIT, CCR of >=80%, ROCE of 8-10% and EPS growth of 5-10% p.a. Dividend payout ratio target of 40-60%.

European Utilities Industry View: NEUTRAL

E.ON (EONGn.DE)

Stock Rating: OVERWEIGHT

Income statement (€mn)	2015A	2016E	2017E	2018E	CAGR
Revenue	44,717	43,953	43,867	43,699	-0.8%
EBITDA (adj)	5,844	4,959	4,984	4,866	-5.9%
EBIT (adj)	3,563	3,068	3,066	2,923	-6.4%
Pre-tax income (adj)	2,078	1,551	2,101	2,109	0.5%
Net income (adj)	1,098	822	1,407	1,408	8.7%
EPS (adj) (€)	0.56	0.42	0.72	0.72	8.7%
Diluted shares (mn)	1,952	1,952	1,952	1,952	0.0%
DPS (€)	0.50	0.17	0.36	0.36	-10.3%

Price (03-Mar-2017) EUR 7.48
 Price Target EUR 8.50

Why Overweight? We like E.ON's 65%-regulated business mix, which gives earnings stability and visibility. We forecast €15% EPS CAGR over 2016-20E, helped by the effect of de-consolidating €8bn of waste-and-storage provisions and applying a lower discount rate to the residual nuclear provisions. E.ON trades on a discount to peers whilst offering a comparable dividend yield.

Margin and return data	Average				
EBITDA (adj) margin (%)	13.1	11.3	11.4	11.1	11.7
EBIT (adj) margin (%)	8.0	7.0	7.0	6.7	7.2
Pre-tax (adj) margin (%)	4.6	3.5	4.8	4.8	4.4
Net (adj) margin (%)	2.5	1.9	3.2	3.2	2.7
ROIC (%)	3.0	2.6	2.7	2.6	2.7
ROA (%)	2.1	1.8	1.9	1.9	1.9
ROE (%)	5.8	4.7	9.2	9.1	7.2

Upside case EUR 10.50

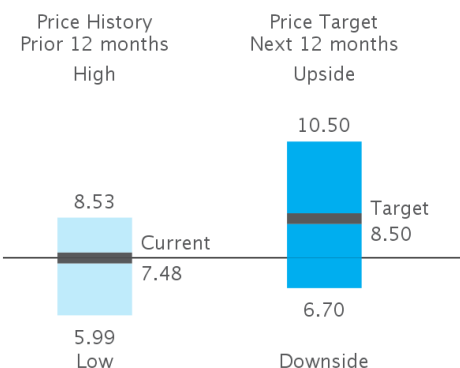
Assumes that E.ON wins the Nuclear Fuel Tax case, which would be worth ~€3bn including interest, or €1.5/share. Our upside case also includes an extra €150m of cost savings in 2017.

Downside case EUR 6.70

Assumes that E.ON loses 5% of UK and German retail customers p.a. over the next few years driven by the very competitive nature of the UK and German market, and a reversion to a more adverse interest-rate environment (which would increase the level of pension provisions).

Balance sheet and cash flow (€mn)	CAGR				
Net PP&E	38,997	36,918	37,410	37,919	-0.9%
Total net assets	181,948	176,189	167,301	169,052	-2.4%
Capital employed	86,084	83,387	80,004	80,261	-2.3%
Shareholders' equity	16,429	12,804	11,911	12,644	-8.4%
Net debt/(funds)	21,340	23,449	24,203	23,504	3.3%
Cash flow from operations	4,191	4,890	-4,100	3,570	-5.2%
Capital expenditure	-2,850	-2,629	-2,410	-2,452	N/A
Free cash flow	4,644	-326	-3,615	156	-67.7%

Upside/Downside scenarios



Valuation and leverage metrics	Average				
P/E (adj) (x)	13.3	17.8	10.4	10.4	13.0
EV/EBITDA (adj) (x)	N/A	8.4	8.6	8.5	8.5
EV/NOPAT (x)	N/A	18.9	19.3	19.8	19.3
Equity FCF yield (%)	31.8	-2.2	-24.8	1.1	1.5
P/BV (x)	0.8	0.9	1.0	0.9	0.9
Dividend yield (%)	6.7	2.3	4.8	4.8	4.6
EV/IC (x)	N/A	0.5	0.5	0.5	0.5
Net debt/EBITDA (adj) (x)	3.7	4.7	4.9	4.8	4.5

Selected operating metrics	Average				
Total installed capacity (MW)	11,157	12,397	12,413	12,949	12,229
Total power output (GWh)	54,564	55,901	56,287	56,588	55,835
RAB (€mn)	17,519	17,825	18,186	18,522	18,013

Source: Company data, Barclays Research

Note: FY End Dec

UNIPER (EW; PT: €14.30): CASH EXCISION FROM PROVISIONS

Higher cash outflows for provisions

UN01 GY / UN01.DE

Stock Rating
EQUAL WEIGHTIndustry View
NEUTRALPrice Target
EUR 14.30Price (03-Mar-2017)
EUR 13.50Potential Upside/Downside
+5.9%

Uniper is to publish its FY2016 results on Wednesday, 15 March, at 7.30 a.m. CET with a presentation by CEO Klaus Schäfer, CFO Christopher Delbrück, and EVP for Group Finance and Investor Relations, Udo Giegerich. In the update below, we first set out our preview for Uniper's FY 2016 results, before explaining the changes we have made to our price target and our EPS and DPS forecasts from 2017 onwards.¹¹

FY16 results preview

Figure 12 shows our FY16 results preview for Uniper. In terms of operations, we expect EBIT to be up 52% year-on-year, driven primarily by Global Commodities, which is reversing losses from the gas-midstream and power-trading businesses in 2015. However, we expect this to be more than offset by declining earnings in the European power-generation business, which continues to suffer from low wholesale power prices and spreads. The negative year-on-year evolution in the International Power division is driven by the fire at Berezovskaya-3.

FIGURE 12
Uniper – FY16 Preview

€m	FY15A	FY16E	YoY	Cons.	Barclays vs. Cons.	Drivers Y/Y
European Generation	506	254	(50%)			(-) Lower spreads & outright (nuclear/hydro) power prices; (+) positive volume effect nuclear/new capacity (Maasvlakte III)
Global Commodities	262	1,062	305%			(+) Strong gas optimization gains; (-) provisions release Gazprom
International Power	236	137	(42%)			(-) Reduction carrying amount of Berezovskaya III; (+) higher capacity payments in Russia
Consolidation	(203)	(238)	17%			(-) One-off Voyager cost-cutting initiative
Adjusted EBIT	801	1,215	52%	1,291	(6%)	
Adjusted EBITDA	1,717	2,072	21%	2,069	0%	
D&A	(916)	(857)	(6%)	(778)	10%	
Adjusted EBIT	801	1,215	52%	1,291	(6%)	
Financial result (adj)	36	(138)	(483%)	-	-	
PBT (adj)	837	1,077	29%	-	-	
Tax (adj)	(396)	(203)	(49%)	-	-	
Minority Interests	328	(73)	(122%)	-	-	
Adj Net Income	769	801	4%			
EPS - Recurrent	2.10	2.19	4%	-	-	
DPS	-	0.55	nm	-	-	
Economic Net Debt	(6,690)	(3,950)	nm	-	-	(+) Nordstream I disposal to E.ON; solid Op. CF
ND/EBITDA	3.9x	1.9x		-		
NOSH	366	366				
Effective tax rate (%)	47.3%	18.9%				

Source: Company information, Bloomberg consensus forecasts, Barclays Research estimates

¹¹ As already explained above (Page 4), our numbers do not yet include the impact of the disposal of the Group's disposal off its stake in Yuzhno-Russkoye, which was only announced on 5 March. See our First Look report of 6 March, *Sale of Yuzhno-Russkoye gas field supports mid-term strategy* for more details on the expected financial impact of this transaction. We will update our numbers for the impact of the Yuzhno-Russkoye disposal after the FY results on 9 March, as this will be the natural opportunity for a full update of our numbers in any case.

In addition to giving details on the 2016 numbers, we would expect Uniper to update the market in more detail on its future plans now that the restrictive prospectus period is over. In particular, we would expect updates on the following:

- **The Voyager cost-cutting programme:** Uniper has previously given a pre-disposal cost-savings target of €400m (2015-18E) split 50/50 between E.ON and Uniper. Reuters reported on 21 February that Uniper intends to cut personnel costs by €100m in the medium term but without specifying whether this was part of the combined €400m already announced. As a result, the question is whether Uniper has identified further potential for cost-cutting above and beyond the number it has so far given the market.
- **Planned disposals and Nordstream-2:** Ever since its CMD last April, Uniper's guidance has been that it is targeting >€2bn of disposals by end-2017¹² with ~€1bn intended for deleveraging and ~€1bn for investing in the Nordstream-2 pipeline project. Last month, Reuters reported that Uniper plans to sell its 48.24% stake in its Italian LNG terminal, reportedly valued at ~€500m. According to the company, the contribution of the terminal, which is consolidated under the equity method, is close to zero owing to low utilisation rates so if indeed the sale of this asset could be achieved at such a price it would achieve half of the Group's deleveraging target while having only a minimal impact on EPS. We would also expect an update on the state of discussions around the Nordstream-2 project and whether management has any other strategic partnerships in mind if ultimately it cannot proceed with Nordstream-2.
- **Dividend outlook going forward:** We would expect an update on Uniper's dividend policy (currently payout is set at a minimum of 75% of adjusted-FFO after maintenance capex). For 2016, Uniper has pledged a €0.55/share dividend to shareholders.
- **Capex guidance:** We would expect an update on existing growth projects Datteln-4 (where new lawsuits are emerging) and Nordstream-2. In its 9-month results, Uniper achieved a reduction in maintenance capex of 27% year-on-year with an overall capex outlook for the FY at €750-850m, and we think management will want to emphasize a continuing focus on discipline with regard to maintenance capex going forward.

Cash excision from provisions

Focused management, but fairly valued for now: We remain EW on Uniper with an unchanged PT of €14.30 although we are yet to take account of the Group's sale of its stake in the Russian gas field Yuzhno-Russkoye, which was announced on 5 March. We update our model to take account of the lower out-turn in the UK capacity payment for 2017-18 than we were previously assuming, and we also lower our assumptions for UK capacity payments for the years 2021/22 and beyond, while after a recent conversation with IR we also now assume higher cash outflows over 2017-19 against provisions. Against that, we have revised down our number for pension provisions in our SOTP to take account of higher benchmark interest rates.

The net impact of all these changes to our SOTP is value-neutral, but the higher cash outflow on provisions we are now assuming, combined with lower assumed strike prices for UK capacity payments, reduces our EPS estimates by an average of 4% over 2017-19. At the same time, the higher cash outflows on provisions we are now modelling also reduces the scope we see for Uniper's dividend, and our revised DPS forecasts over 2017-19 are now 7% lower on average over this period than previously. On our updated numbers, Uniper trades on forward P/E multiples of 12.7x and 10.3x for 2017 and 2018, respectively, vs. 13.2x and 12.6x for the average of Integrated and Generator utilities, and yields 4.3% for

¹² Although we have not yet included the impact of the Yuzhno-Russkoye in our numbers at this stage, this transaction effectively means that management has now achieved its disposals target well ahead of schedule.

2017 and 5.1% for 2018 compared with 5.1% and 5.4% for the average of Integrated and Generator utilities.

Key to delivering on market expectations going forward will be a smooth operational performance, in particular the start-up of Datteln-4 and the re-start of Berezovskaya-3 – and discipline on capex.

Falling merchant exposure and optionality on tougher German and EU climate policy: We expect Uniper's exposure to merchant-pricing-based activities to decline from ~60% in 2016 to ~40% by the end of the decade, driven by the start-up of the long-term contracted Datteln-4 in Germany and increasing dependence on capacity payments in the UK and Russia. Potential future growth projects could reduce commodity-price exposure even further although we have not taken growth projects (to be financed by disposals) into account in our base-case modelling. Before disposals we now forecast ND/EBITDA to reach 2.5x by year-end 2017 and 1.3x by year-end 2019. Moreover, we think Uniper's portfolio of generation assets in Germany and across the EU is well positioned to take advantage of any future tightening in German and EU climate policy as its gas and new high-efficiency coal-fired generation assets could become much more valuable under such a scenario.¹³

Uniper: Risks to Thesis and Valuation: The main downside risks are the €2bn of targeted disposals by end-2017 (a risk to our earnings forecasts with added execution risk)¹⁴ and a later start-up of Datteln-4 and re-start of Berezovskaya-3 than we assume. The main upside risks are higher German and UK power prices than we are assuming.

Valuation: Fair value and PT unchanged at €14.30

Figure 13 shows our updated SOTP valuation for Uniper. Our unchanged fair value for the Group's equity is €5.2bn, which equates to €14.30/share.

We have made four main changes to our valuation.

- **Utilisation of provisions leads to cash outflow (-€1.90/share):** After a recent conversation with the company, we now understand Uniper's cash obligations against provisions over 2017-19 to average €550-700m per year. This breaks down as (i) ~€200-300m per year on provisions built up for loss-making contracts in Global Commodities on re-gasification, storage and transmission; (ii) ~€100m per year on provisions set up for the service operations of Swedish nuclear power (not covered by the Swedish nuclear fund); (iii) a total property tax of ~€260m to be triggered in 2017 and 2018; and (iv) ~€120m in total personnel/early-retirement provisions for restructuring measures with the majority to be utilised in 2017. Overall, we now factor in an extra cash outflow of €700m in 2017, €600m in 2018 and €400m in 2019.
- **Provision release reduces 'other provisions' in our SOTP (+€1.90/share):** The release of provisions that were build up in the past leads us to reduce the negative SOTP item of 'Other provisions' by €700m at year-end 2017 vs. our previous numbers.
- **Accounting for updated UK capacity-market strike prices (-€0.30/share):** We update our model for the latest UK capacity strike prices for the delivery years 2017/18 and also now assume lower outcomes for 2021/22 and beyond. The impact of a €5/kW lower strike price for the years 2021/22 and 2022/23 as well as a €2.5/kW reduction beyond those years, reduces our fair value by €0.30/share.

¹³ As explained in our report *'German Utilities: Scoping the 'Tragedy of the Horizon'*, 1 September 2016, we think Germany will have to put in place measures to reduce emissions significantly faster than currently foreseen if it is to reach its 2030 target, and we would also expect the EU to revisit its climate targets within the timeframe foreseen by the Paris Agreement (i.e. over 2018-23).

¹⁴ Again, this is before the disposal of Yuzhno-Russkoye, which – as per our First Look report of 6 March, *Sale of Yuzhno-Russkoye gas field supports mid-term strategy* and hence before including it in our numbers – we estimate will result in a normalized full-year dilution to adjusted EPS of ~13%.

FIGURE 13

Uniper – Fair value sum-of-the-parts valuation

	Method	€m	€/share	EV/EBITDA FY17	EV/EBITDA FY18
European Generation	DCF	5,695	15.6	9.2x	7.6x
Hydro	DCF	3,789	10.4	10.3x	11.4x
Nuclear	DCF	436	1.2	7.1x	18.9x
Coal/Lignite	DCF	893	2.4	58.8x	8.3x
Gas	DCF	578	1.6	nm	5.6x
Global Commodities	Multiples	3,063	8.4	5.1x	4.9x
International Power	Market Value Unipro, DCF	2,915	8.0	4.7x	3.9x
Consolidation	Multiples	(819)	(2.2)	6.0x	6.0x
Enterprise Value	-	10,853	29.7	6.7x	6.1x
Share Investments	Book value YE17	577	1.6	1x	-
Treasury	At SOTP Fair Value	-	-	-	-
Fin Net Debt, incl Fin Assets	Book value YE17	(1,744)	(4.8)	1x	-
Pension Provisions	Book value YE17	(1,123)	(3.1)	1x	-
Asset Retirement Obligations	Book value YE17	(1,022)	(2.8)	1x	-
Other Provisions	Book value YE17	(1,746)	(4.8)	-	-
Minorities	At 10x PE	(556)	(1.5)	10x	-
Equity Value	-	5,240	-	-	-
Share count (m)	366.0				
Price Target			14.3		

Source: Barclays Research estimates

- **Adjusting down pension provisions by €100m (+€0.3/share):** Given the change in the macro interest-rate environment since our last update, we feel it appropriate to reduce the value of pension provisions accordingly.

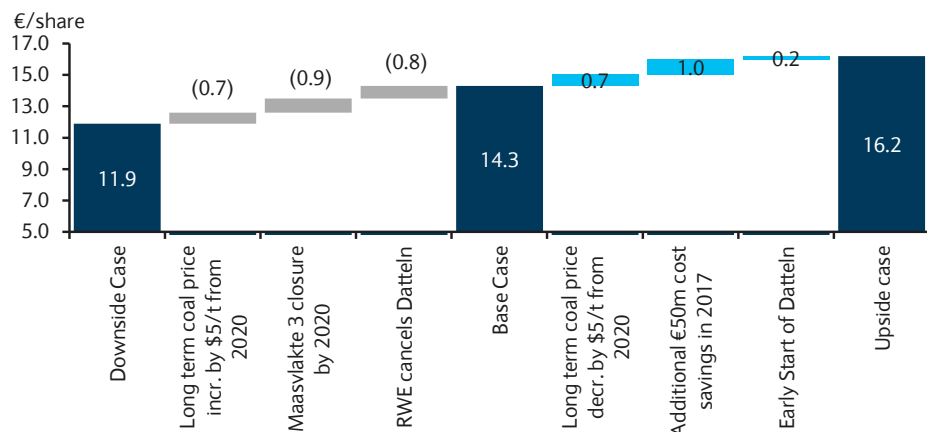
Figure 14 then shows our upside and downside cases against our revised fair value.

Upside case (€16.20/share): Our upside scenario assumes (i) that the long-term coal price is higher by \$5/t from 2020 onwards than the \$56/t we have in our base case; (ii) that an additional €50m of sustainable cost savings are realized in 2017; and (iii) that Datteln-4 starts in Q1 2018 compared with Q3 2018 in our base case.

Downside case (€11.90/share): Our downside scenario assumes (i) that the long-term coal price is lower by \$5/t from 2020 onwards than the \$56/t we have in our base case; (ii) that Maasvlakte-3 closes early in 2020 with no compensation paid to Uniper; and (iii) that RWE cancels its long-term contract with Uniper's 1.1GW Datteln-4 coal plant with no compensation paid (we understand that RWE holds a 400MW contract).

FIGURE 14

Upside and downside scenario



Source: Barclays Research estimates

EPS and DPS forecasts reduced

We reduce our EPS forecasts over 2017-19 by an average of 4% to take account of (i) lower UK capacity-market strike prices than we were previously assuming and (ii) the impact of higher interest charges flowing from the higher net-debt estimates we now have as a result of higher cash outflows against provisions. Figure 9 shows our revised EPS numbers vs. our previous estimates.

FIGURE 15

Uniper – Changes to our EPS forecasts

DPS, €/share	2016E	2017E	2018E	2019E
Previous	2.19	1.10	1.36	1.75
New	2.19	1.06	1.31	1.68
Change	0%	(3.9%)	(3.5%)	(4.0%)

Source: Barclays Research estimates

At the same time, given the higher cash outflows against provisions over 2017-2019 that we now have in our updated numbers, we reduce our DPS forecasts over this period by an average of 6% over 2017-19, while our estimates for Uniper's ND/EBITDA ratio over this period are also higher than before. Figure 10 shows our revised DPS and ND/EBITDA ratios over 2017-19 vs. our previous estimates.

FIGURE 16

Uniper – Changes to our dividend and ND/EBITDA ratio forecasts

DPS, €/share	2016E	2017E	2018E	2019E
Previous	0.55	0.58	0.76	1.05
New	0.55	0.58	0.69	0.96
Change	0%	(0.7%)	(9.4%)	(8.8%)
ND/EBITDA	2016E	2017E	2018E	2019E
Previous	1.9x	2.0x	1.3x	0.6x
New	1.9x	2.4x	1.9x	1.3x

Source: Barclays Research estimates

European Utilities						Industry View: NEUTRAL
Uniper SE (UN01.DE)						Stock Rating: EQUAL WEIGHT
Income statement (€mn)	2015A	2016E	2017E	2018E	CAGR	Price (03-Mar-2017)
Revenue	92,115	92,781	92,042	92,106	0.0%	EUR 13.50
EBITDA (adj)	1,717	2,072	1,622	1,776	1.1%	Price Target
EBIT (adj)	801	1,215	741	898	3.9%	EUR 14.30
Pre-tax income (adj)	837	1,077	591	729	-4.5%	Why Equal Weight? While 2017 should be the trough year for earnings, we project a 3-year EBITDA CAGR of >9% driven mainly by the start-up of new capacity and increasing dependence on capacity mechanisms. We think €200m in dividends p.a. are sustainable after maintenance capex reduction, resulting in one of the most attractive dividend yields of our sector at 7% in 2019E.
Net income (adj)	769	801	388	480	-14.5%	
EPS (adj) (€)	2.10	2.19	1.06	1.31	-14.5%	
Diluted shares (mn)	366.0	366.0	366.0	366.0	0.0%	
DPS (€)	0.00	0.55	0.58	0.69	N/A	
Margin and return data					Average	Upside case
EBITDA (adj) margin (%)	1.9	2.2	1.8	1.9	1.9	EUR 16.20
EBIT (adj) margin (%)	0.9	1.3	0.8	1.0	1.0	Assumes that the long-term coal price increases by \$5/t from 2020 onwards, that an additional €50m of sustainable cost savings will be employed in 2017, and that Datteln starts in 1Q18 (versus our base-case assumption of 2Q18)
Pre-tax (adj) margin (%)	0.9	1.2	0.6	0.8	0.9	
Net (adj) margin (%)	0.8	0.9	0.4	0.5	0.7	
ROIC (%)	1.3	2.2	1.5	1.8	1.7	
ROA (%)	0.9	1.5	1.0	1.2	1.1	
ROE (%)	4.1	5.8	3.0	3.5	4.1	Downside case
Balance sheet and cash flow (€mn)					CAGR	EUR 11.90
Net PP&E	14,297	9,355	9,314	9,075	-14.1%	Assumes that the long-term coal price falls by \$5/t from 2020 onwards, that Maasvlakte-3 closes early in 2020 with no compensation paid, and that RWE cancels its LTC with Datteln-4 with no compensation paid to Uniper.
Total net assets	15,001	12,853	13,336	13,917	-2.5%	
Capital employed	42,065	36,105	36,062	35,644	-5.4%	
Shareholders' equity	14,461	12,397	12,943	13,602	-2.0%	
Net debt/(funds)	6,690	3,850	3,889	3,353	-20.6%	
Cash flow from operations	1,465	2,283	915	1,300	-3.9%	
Capital expenditure	-1,083	-715	-840	-640	N/A	
Free cash flow	382	1,568	75	659	20.0%	
Valuation and leverage metrics					Average	Upside/Downside scenarios
P/E (adj) (x)	6.4	6.2	12.7	10.3	8.9	Price History Prior 12 months High
EV/EBITDA (adj) (x)	N/A	6.3	4.5	6.1	5.6	Price Target Next 12 months Upside
EV/EBIT (adj) (x)	N/A	10.8	9.8	12.0	10.9	14.35 Current 13.50 9.80 Low
Equity FCF yield (%)	9.0	36.8	1.8	15.5	15.8	16.20 Target 14.30 11.90 Downside
P/BV (x)	0.3	0.4	0.4	0.4	0.4	
Dividend yield (%)	0.0	4.0	4.3	5.1	3.4	
Net debt/capital (%)	15.9	10.7	10.8	9.4	11.7	
Net debt/EBITDA (adj) (x)	3.9	1.9	2.4	1.9	2.5	
Selected operating metrics (€)					Average	
Total installed capacity (MW)	40,116	39,924	39,805	39,686	39,883	
Total power output (GWh)	138,935	144,083	151,243	150,771	146,258	
Baseload power price Germany (€/MWh)	35.1	28.1	27.6	26.5	29.3	
Baseload power price UK (£/MWh)	43.4	40.4	46.9	43.0	43.4	
Achieved CDS - Germany (€/MWh)	16.6	11.8	7.4	6.4	10.6	
Achieved CSS - Germany (€/MWh)	0.4	3.7	-1.4	-3.4	-0.1	
Achieved CDS - UK (£/MWh)	10.2	7.8	1.7	3.5	5.8	
Achieved CSS - UK (£/MWh)	5.9	12.3	4.5	6.6	7.3	

Source: Company data, Barclays Research
Note: FY End Dec

RWE (EW; PT: €13.10): CASH CARRIED: FOCUS NOW ON UPCOMING CMD

FY headline numbers pre-released; focus now on CMD

RWE GY / RWE G.DE

Stock Rating
EQUAL WEIGHTIndustry View
NEUTRALPrice Target
EUR 13.10Price (03-Mar-2017)
EUR 14.01Potential Upside/Downside
-6.5%

RWE is to release its full set of results on 14 March at 7 a.m. CET followed by a call at 2 p.m. CET. The conference call will be hosted by CFO Markus Krebber and the Head of Investor Relations, Gunhild Grieve,

As explained in our report *Cash carried: pre-release postpones dividend*, RWE pre-released the headline numbers for its FY16 results on 22 February and suspended its common dividend for the second year in a row. Management cited the squeeze on its finances from Germany's nuclear funding proposal as the reason behind the dividend suspension although, in our view, the unexpected €4.3bn impairment on power plants across the EU that it announced did not help either. RWE also stated that in future the relevant yardstick for gauging the capacity for dividend payouts will be its cash-flow generation (including the dividend it receives from Innogy) rather than EPS.

We have argued previously (see, for example, our report of 13 December 2016, *RWE: Brownian coal motion: not so random*, and of 10 February 2017, *RWE: Cash or carry?*), that RWE's scope to pay a dividend on a cash-flow basis could be significantly higher than what we currently forecast and that on our numbers a common DPS of €0.50 can certainly be paid out on a sustainable basis to 2020. Thereafter, however, we think that much will depend on the policy measures put in place by the next German government in implementing the Climate Action Plan 2050 (CAP 2050), and if Germany is serious about achieving its emissions-reduction targets out to 2030 and beyond, that the implications for RWE's lignite-fired generation capacity could be very negative (again, see the reports just referenced – *RWE: Brownian coal motion: not so random* and *RWE: Cash or carry?* – for our detailed analysis of the CAP 2050 and its potential impact on RWE beyond 2020). We would also note that a DPS of €0.5 still implies a dividend yield of only 3.6% for 2017 and 2018 vs. peers at 5.3% and 5.6%, respectively.

Figure 9 shows the headline numbers for RWE's FY 2016 results vs. our forecasts.

FIGURE 17

RWE – headline numbers for 2016 pre-released on 22 February

€m	FY16A	FY16E Barclays	FY16E Consensus	FY15A
Adjusted EBITDA	5,400	5,479	5,482	7,017
Adjusted EBIT	3,100	3,054	3,083	3,837
Adj. Net Income	800	618	669	1,125
EPS - Recurrent	1.30	1.00	1.09	1.83
DPS	0.0	0.25	0.30	0.0
Economic Net Debt	(22,700)	(23,004)	nm	(25,463)
ND/EBITDA	4.2	4.2x		3.6x

Source: Company information, company-compiled consensus forecasts, Barclays Research estimates

The numbers reported were at the upper end of the range for EBITDA (€5.4bn vs. guidance of €5.2-€5.5bn) and EBIT (€3.1bn vs. guidance of €2.7-€3.1bn) and a clear beat for Adjusted Net Income (€800m vs. guidance of €500m-€700m) although we will have to wait for the full 2016 results presentation on 14 March for details on which elements below the operating line drove the earnings beat. Taking into account proceeds from the Innogy IPO, RWE's net debt now stands at €22.7bn, down €2.8bn year-on-year.

Figure 10 then shows our estimates for the breakdown of RWE's FY2016 Group EBIT. These numbers were not released on 22 February and are to be published with the annual report and all the other detailed information on the Group's 2016 performance on 14 March.

FIGURE 18

RWE – Barclays Research estimate for breakdown of FY16 EBIT

€m	FY15A	FY16E	YoY Cons.	Barclays vs. Cons.	Drivers Y/Y
Conventional Power Generation	596	590	(1%)	-	(-) Lower spreads & outright (nuclear) power prices; (+) lower NFT/efficiency improvements/lower depreciation from prior year impairments
Trading/Gas midstream	156	36	(77%)	-	(-) Very weak trading performance in 9M16
Innogy	3,050	2,698	(12%)	-	(-) Photo year German Grid/Renew. book gains in 2015/fx effects/UK Retail
Consolidation	35	(270)	(871%)		(-) Restructuring effects
Adjusted EBIT	3,837	3,054	(20%)	3,083	(1%)

Source: Company information, company-compiled consensus, Barclays Research estimates

Group strategy now in focus for CMD on 28 March

On our numbers, RWE trades on 2017 and 2018 P/E multiples of 11.2x and 12.4x, respectively, (versus sector peers on 13.2x and 12.6), making it one of the cheapest stocks in our universe on this metric. However, there is still a lot of uncertainty around the Group's future strategy and valuation, some of which relates to factors within management's control (the balance between dividends and capex), and some of which relates to factors beyond management's control (future German climate policy and the implications of this for RWE's lignite power-generation business).

As explained in our report of 10 February, *RWE: Cash or carry?*, our numbers indicate that after taking into account the dividend from Innogy, RWE has scope to pay a higher dividend than the €0.5 it recently committed to for 2017 (and which will then serve as a floor for the following years). However, the question management must answer at the CMD is this: what is the long-term balance it wants to strike between (i) paying a generous dividend; (ii) having scope for some growth capex while setting aside funds for future liabilities; and (iii) preparing for what might be a materially tougher long-term future if the next German Government moves aggressively to implement the Climate Action Plan 2050 (CAP 2050) (which would be bearish for RWE's lignite and coal-fired generation)?

Realistically, the first of these questions has already been answered with the new guidance on future dividend policy given on 22 February, but a DPS of €0.50 still implies a dividend yield of only 3.6% for 2017 and 2018 vs. peers at 5.1% and 5.4%, respectively, so management might wish to give clearer guidance for 2018 and beyond.

As a result, the CMD on 28 March is the opportunity for management to clarify its future strategy on dividends and growth capex and to set out its plans for managing the risks associated with its lignite portfolio in the face of Germany's CAP 2050 plan.

Risks to thesis and valuation: On a 12-month view, the main upside risks are that RWE wins its NFT appeal (worth €2.9/share) and that long-term coal and power prices move above the levels assumed in our base case. The main downside risk is that long-term coal and power prices move below the levels we assume in our base case. Beyond a 12-month horizon, the main risk is that the implementation of Germany's CAP 2050 plan leads to an accelerated reduction of lignite and hard coal in Germany's generation mix, with bearish implications for RWE's conventional power business.

European Utilities	Industry View: NEUTRAL
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RWE (RWE.G.DE)	Stock Rating: EQUAL WEIGHT
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Income statement (€mn)	2015A	2016E	2017E	2018E	CAGR
Revenue	48,090	49,569	49,123	48,693	0.4%
EBITDA (adj)	7,017	5,479	5,612	5,386	-8.4%
EBIT (adj)	3,837	3,054	3,237	3,133	-6.5%
Pre-tax income (adj)	-637	1,279	1,850	1,816	N/A
Net income (adj)	1,125	618	765	694	-14.9%
EPS (adj) (€)	1.83	1.00	1.24	1.13	-14.9%
Diluted shares (mn)	614.7	614.7	614.7	614.7	0.0%
DPS (€)	0.13	0.25	0.25	0.25	24.4%

Price (03-Mar-2017)	EUR 14.01
Price Target	EUR 13.10

Why Equal Weight? We forecast EPS growth of 3% on average over 2017-20E driven by risk-adjusting RWE's remaining nuclear provisions. However, key uncertainties remain over RWE's growth capex strategy and dividend policy, with an update expected end March 2017. RWE trades on a slight premium with sector peers on EV/EBITDA, and an unattractive dividend yield of ~2%.

Margin and return data	Average				
EBITDA (adj) margin (%)	14.6	11.1	11.4	11.1	12.0
EBIT (adj) margin (%)	8.0	6.2	6.6	6.4	6.8
Pre-tax (adj) margin (%)	-1.3	2.6	3.8	3.7	2.2
Net (adj) margin (%)	2.3	1.2	1.6	1.4	1.6
ROIC (%)	5.0	4.4	4.8	4.7	4.7
ROA (%)	3.3	2.8	3.1	3.1	3.1
ROE (%)	10.9	7.0	9.3	8.6	9.0

Upside case	EUR 16.90
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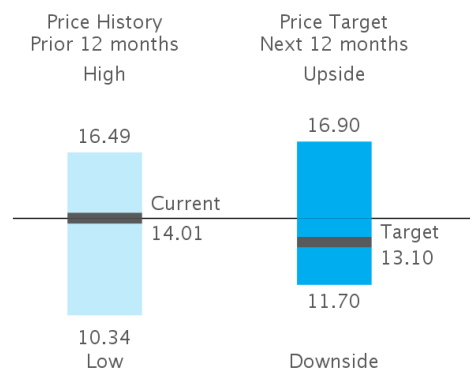
Our upside scenario assumes (i) that the long-term coal price increases by \$5/t by 2020 (from currently \$55/t); and (ii) that RWE wins the nuclear-fuel-tax case, receiving back ~€1.7bn (plus 6% interest) pre tax or €2.9/share.

Downside case	EUR 11.70
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Our downside case assumes that the long-term coal price drops by \$5/t by 2020 (from currently \$55/t), and that UK capacity payments for gas and coal are £5/kW lower than our estimates for the years 2021/22 onwards.

Balance sheet and cash flow (€mn)	CAGR				
Net PP&E	29,357	29,551	29,639	29,895	0.6%
Total net assets	8,894	8,713	7,686	8,391	-1.9%
Capital employed	51,798	48,913	48,522	48,161	-2.4%
Shareholders' equity	5,847	5,590	4,401	4,941	-5.5%
Net debt/(funds)	25,463	23,004	24,059	23,144	-3.1%
Cash flow from operations	3,214	4,648	-683	4,165	9.0%
Capital expenditure	-3,303	-2,528	-2,464	-2,509	N/A
Free cash flow	441	2,630	-2,847	1,955	64.3%

Upside/Downside scenarios



Valuation and leverage metrics	Average				
P/E (adj) (x)	7.7	13.9	11.3	12.4	11.3
EV/EBITDA (adj) (x)	N/A	7.5	8.2	8.3	8.0
EV/NOPAT (x)	N/A	18.7	19.6	19.8	19.4
Equity FCF yield (%)	5.9	35.4	-38.4	26.3	7.3
P/BV (x)	1.0	1.0	1.1	1.0	1.0
Dividend yield (%)	0.9	1.8	1.8	1.8	1.6
Net debt/EBITDA (adj) (x)	3.6	4.2	4.3	4.3	4.1

Selected operating metrics (€)

Payout ratio (%)	N/A	24.9	20.1	22.2
Baseload power price Germany (€/MWh)	35.1	28.1	27.6	26.5
Baseload power price UK (£/MWh)	43.4	40.4	46.9	43.0
Achieved CDS - Germany (€/MWh)	16.6	11.8	8.9	7.9
Achieved CSS - Germany (€/MWh)	0.4	3.7	-1.4	-3.4
Achieved CDS - UK (£/MWh)	10.2	7.8	1.7	2.8
Achieved CSS - UK (£/MWh)	5.9	12.3	4.5	5.9

Source: Company data, Barclays Research
Note: FY End Dec

INNOGY (EW, €33 PT): STEADY AS SHE GOES

FY16 Preview

IGY GY / IGY.DE

Stock Rating
EQUAL WEIGHTIndustry View
NEUTRALPrice Target
EUR 33.00Price (03-Mar-2017)
EUR 33.91Potential Upside/Downside
-2.7%

Innogy is to release its FY16 results at 7 a.m. CET with a conference call presented by Peter Terium (CEO) and Bernhard Guenther (CFO) at 12:30 p.m. CET.

Figure 19 shows our FY preview for Innogy. We expect the operating result to come in slightly below market expectations, driven by lower wind yields than in 2015. We think that the negative effect of Germany's photo year in Energy Networks is well known by the market but that its Eastern networks unit could remain a swing factor.

In Retail, we would expect a recovery in the UK driven by Innogy's efficiency programme. Overall EBITDA guidance is €4.1-4.4bn while we are slightly higher at €4.2bn. We forecast EPS to be down -28% year-on-year, owing mainly to the financial result being negatively affected by RWE's bond transfer to Innogy. In terms of Net Income, Innogy is guiding towards ~€1.1bn for the FY with our forecast at €1.129bn. We expect a 2016 dividend of €1.62/share, implying a payout ratio of 80%, the upper end of Innogy's 70-80% guidance.

We expect Innogy to elaborate on capex plans going forward, i.e. new regions for renewable (Mena) and further efforts in broadband projects (Innogy highspeed).

FIGURE 19

Innogy – FY16 preview

€m	FY15A	FY16E	YoY	Cons.	Barclays vs Cons.	Drivers Y/Y
Energy Networks	1,930	1,600	(17%)	1,675	(4%)	
Germany	1,282	957	(25%)	-	-	(-) Photo Year effect/pos. Prior year effect from revaluation gain; (+) book gain from disposal
East	648	643	(1%)	-	-	(+) Colder weather led to higher volumes; (-) absence from one-off revaluation gain
Retail	830	881	6%	869	1%	
Germany	545	478	(12%)	-	-	(-) Margin pressure; (+) efficiency improvement
NL/Belgium	194	157	(19%)	-	-	(-) Customer losses/absence of pos. Effect from provision release
UK	(137)	70	(151%)	-	-	(+) Recovery from process- and system-related problems in billing system in prior year; (-) Customer losses/higher D&A due to higher infrastructure capex
East	228	176	(23%)	-	-	(-) Absence of one-off revaluation gain from full-time consolidation of VSE; (+) Full consolidation of VSE and contribution on earnings
Renewables	488	347	(29%)	362	(4%)	(-) weak sterling/lower overall prices/book gains in 2015/low wind yields; (+) Contribution of new capacity in offshore wind
Consolidation	(198)	(130)	(34%)	-	-	(+) Restructuring effects
Operating Result	3,050	2,698	(12%)	2,717	(1%)	
Adjusted EBITDA	4,521	4,198	(7%)	4,187	0%	
D&A	(1,471)	(1,500)	2%	(1,470)	2%	
Adjusted EBIT	3,050	2,698	(12%)	2,717	(1%)	
Financial result (adj)	(302)	(781)	159%	-	-	(-) Amortisation of 'step-up' per senior bond as nominal value < market value at time of transfer
PBT (adj)	2,748	1,918	(30%)	1,631	-	
Tax (adj)	(860)	(521)	(39%)	-	-	
Minority Interests	(325)	(267)	(18%)	-	-	(+) In line with profit evolution networks
Adj. Net Income	1,563	1,129	(28%)	1,122	1%	
EPS - Recurrent	2.81	2.03	(28%)	2.02	1%	
DPS	-	1.62	nm	1.56	4%	
Economic Net Debt	(6,788)	(16,237)	nm	(16,968)	(4%)	(-) Debt pushdown from RWE
ND/EBITDA	1.5x	3.9x		4.0x		
NOSH	556	556				
Eff. Tax rate (%)	31.3%	27.2%				

Source: Company information, Vara consensus forecasts, Barclays Research estimates.

Valuation: Fair value and PT unchanged at €33, remain EW

We like Innogy's defensive-growth profile and attractive dividend policy: we project an EPS CAGR over 2016-20 of 6% and an average payout ratio of 74%, implying a 2017 yield of 5.4%. The main growth driver is the Renewables business, and with our model assuming a fall in the leverage ratio from 3.9x as of year-end 2016 to 3.1x by 2020, there is scope for higher growth capex than we are projecting. Innogy's defensive-growth profile is attractive, but at the current levels, we think the shares look fairly valued relative to peers.

Figure 20 shows our updated SOTP for Innogy. Our SOTP-derived PT remains €33, and with the shares currently trading at only a modest premium to this level, we remain EW.

FIGURE 20

Innogy – sum-of-the-parts valuation

	Method	€m	€/share	EV/EBITDA FY17	EV/EBITDA FY18
Energy Networks	RAB + Outperf.	25,077	45.1	9.4x	9.2x
Retail	DCF, TV	6,439	11.6	5.9x	5.8x
Renewables	DCF	7,395	13.3	10.7x	9.8x
Wind/Solar	DCF	6,564	11.8	10.7x	9.6x
Hydro	DCF	831	1.5	10.6x	12.3x
Corporate Function	Multiple	(780)	(1.4)	6.0x	6.0x
Enterprise Value	-	38,131	68.6	8.8x	8.5x
Share Investments	Book value YE17	561	1.0	1.0x	-
Fin Net Debt, incl Fin Assets	Book value YE17	(11,214)	(20.2)	1.0x	-
o/w IPO Proceeds	Market value	2,002	3.6		
Pension Provisions	Book value YE17	(4,401)	(7.9)	1.0x	-
ARO provisions	Book value YE17	(364)	(0.7)	1.0x	-
Other Provisions	Book value YE17	(1,032)	(1.9)	0.3x	-
Minorities	At 12x PE	(3,358)	(6.0)		12x
Equity Value	-	18,322	33.0	-	-
Number of shares (mn)	556.0				
Price Target			33.0		

Source: Barclays Research estimates

While our fair value and price target are unchanged, we have made two minor and changes to our SOTP, which offset one another:

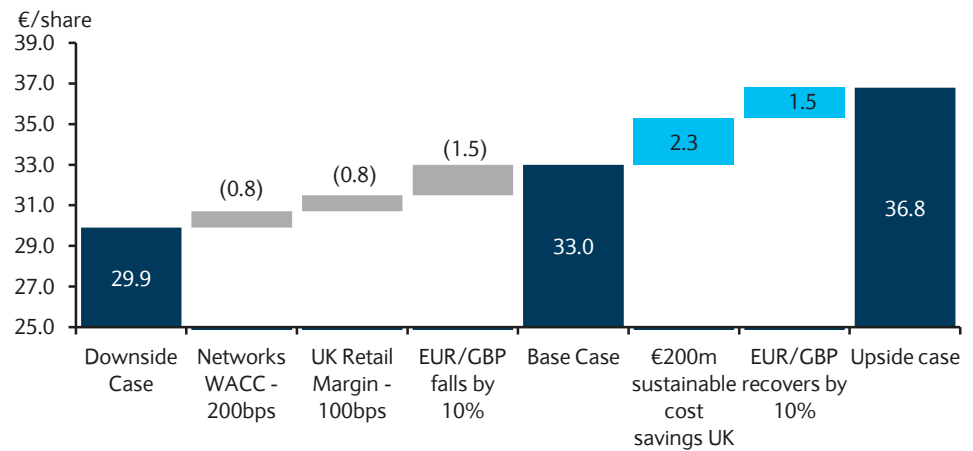
- **Reduction of pension provisions by €750m (+€1.40/share):** In line with its peers, we expect Innogy's pension provisions to fall as a result of the recovery in benchmark yields.
- **Higher minority interests (-€1.40/share):** We are raising the multiple we use to value Innogy's minority interests to 12x P/E vs. 10x previously, in line with the 2018 average for integrated peers.

Figure 21 then shows our upside and downside cases against our fair value of €33/share.

Upside case (€36.80/share): Our upside scenario assumes an incremental €200m of sustainable cost savings employed in the UK and a recovery in the EUR/GBP rate by 10% from 2017 onwards versus our base case (to 0.99 vs. 0.90 in our base case).

Downside case (€29.90/share): Our downside case assumes that returns in Eastern networks fall by 200 basis points, that UK retail margins drop by 100 basis points from 2017 versus our base case (1.7% vs. 2.7%), and a drop in the EUR/GBP exchange rate of 10% from 2017 onwards.

FIGURE 21
Upside and downside scenario



Source: Barclays Research estimates

Innogy offers an attractive dividend policy but looks fairly valued for now

At the current share price, our Innogy numbers imply 2017 and 2018 P/E multiples of 13.6x and 13.0x vs. 15.8x and 15.2x for network utilities and 12.9x and 12.2x for integrated utilities. Our implied 2017 and 2018 dividend yields of 5.4% and 5.6% are in line with or slightly below peers, with network utilities on 4.9% and 5.1%, and integrated utilities 5.1% and 5.4%. With the shares looking fairly valued against both peers and our PT, we remain EW.

Risks to thesis and valuation: The main downside risks to our valuation are a further depreciation of sterling versus the euro, and a slower rebound in the UK retail business than we are assuming. The main upside risk is faster growth in Renewables than we are assuming.

European Utilities						Industry View: NEUTRAL
Innogy SE (IGY.DE)						Stock Rating: EQUAL WEIGHT
Income statement (€mn)	2015A	2016E	2017E	2018E	CAGR	Price (03-Mar-2017)
Revenue	43,456	45,605	45,825	45,979	1.9%	EUR 33.91
EBITDA (adj)	4,521	4,198	4,335	4,483	-0.3%	Price Target
EBIT (adj)	3,050	2,698	2,874	2,994	-0.6%	EUR 33.00
Pre-tax income (adj)	2,748	1,918	2,145	2,251	-6.4%	Why Equal Weight? We like Innogy's defensive-growth profile and attractive dividend policy. We assume that proceeds from the 10% IPO are used for further de-leveraging, though we acknowledge the scope for further growth capex. However, the stock looks fairly valued relative to peers and we prefer E.ON at this stage.
Net income (adj)	1,563	1,129	1,277	1,343	-4.9%	
EPS (adj) (€)	3.13	2.03	2.30	2.42	-8.2%	
Diluted shares (mn)	500.0	556.0	556.0	556.0	3.6%	
DPS (€)	N/A	1.62	1.70	1.75	N/A	
Margin and return data					Average	Upside case
EBITDA (adj) margin (%)	10.4	9.2	9.5	9.7	9.7	EUR 36.80
EBIT (adj) margin (%)	7.0	5.9	6.3	6.5	6.4	Assumes €200m of sustainable cost savings employed in the UK and a recovery in the EUR/GBP rate by 10% from 2017 onwards.
Pre-tax (adj) margin (%)	6.3	4.2	4.7	4.9	5.0	
Net (adj) margin (%)	3.6	2.5	2.8	2.9	2.9	Downside case
ROIC (%)	4.8	4.2	4.4	4.6	4.5	EUR 29.90
ROA (%)	3.8	3.2	3.4	3.6	3.5	Assumes that returns in Eastern networks fall by an extra 200 basis points; UK retail margins drop by 100 basis points from 2017 and a drop in the GBP/EUR exchange rate of 10% from 2017 onwards.
ROE (%)	8.5	5.5	5.5	5.6	6.3	
Balance sheet and cash flow (€mn)					CAGR	Upside/Downside scenarios
Net PP&E	18,308	29,759	30,115	30,498	18.5%	
Total net assets	92,244	98,791	99,649	100,664	3.0%	
Capital employed	45,945	46,768	47,209	47,446	1.1%	
Shareholders' equity	16,649	20,863	21,340	21,841	9.5%	
Net debt/(funds)	6,788	16,237	15,979	15,485	31.6%	
Cash flow from operations	2,755	2,605	3,170	3,510	8.4%	
Capital expenditure	-1,996	-1,896	-1,817	-1,871	N/A	
Free cash flow	60	686	-36	0	-100.0%	
Valuation and leverage metrics					Average	
P/E (adj) (x)	10.8	16.7	14.8	14.0	14.1	
EV/EBITDA (adj) (x)	N/A	9.4	9.0	8.7	9.0	
EV/NOPAT (x)	N/A	20.2	19.0	18.0	19.1	
Equity FCF yield (%)	4.5	3.8	7.2	8.7	6.0	
P/BV (x)	0.9	0.8	0.8	0.8	0.8	
Dividend yield (%)	N/A	4.8	5.0	5.2	5.0	
EV/IC (x)	N/A	0.8	0.8	0.8	0.8	
Net debt/EBITDA (adj) (x)	1.5	3.9	3.7	3.5	3.1	
Selected operating metrics					Average	
Total installed capacity (MW)	2,948	3,064	3,238	3,317	3,142	
Total power output (GWh)	8,127	8,761	9,786	10,298	9,243	
RAB (€mn)	13,579	13,933	14,299	14,661	14,118	

Source: Company data, Barclays Research
Note: FY End Dec

ANALYST(S) CERTIFICATION(S):

We, Mark Lewis and Jutta Unmuessig, hereby certify (1) that the views expressed in this research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this research report and (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this research report.

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Primary Stocks (Ticker, Date, Price)

E.ON (EONGn.DE, 03-Mar-2017, EUR 7.48), Overweight/Neutral, CD/D/E/FB/J/K/L/M/N

Other Material Conflicts: The CEO of E.ON's Climate & Renewables division is the brother of the lead analyst covering this issuer.

Innogy SE (IGY.DE, 03-Mar-2017, EUR 33.91), Equal Weight/Neutral, CD/D/J/K/L/M/N

RWE (RWEg.DE, 03-Mar-2017, EUR 14.01), Equal Weight/Neutral, CD/D/J/K/L/M/N

Uniper SE (UN01.DE, 03-Mar-2017, EUR 13.50), Equal Weight/Neutral, A/CD/D/E/J/K/L/M/N

Materially Mentioned Stocks (Ticker, Date, Price)

Centrica Plc. (CNA.L, 03-Mar-2017, GBp 228), Equal Weight/Neutral, CD/D/J/K/L/M/N

Drax Group Plc. (DRX.L, 03-Mar-2017, GBp 349), Equal Weight/Neutral, D/E/J/K/L/M/N

Electricite de France (EDF.PA, 03-Mar-2017, EUR 9.69), Overweight/Neutral, A/CD/D/E/J/K/L/M/N

Other Material Conflicts: Barclays and/or affiliates are acting as advisor to Areva on the potential sale of a stake in Areva NP to EDF. The rating and price target (as applicable) do not incorporate the effects of this transaction

Enagas SA (ENAG.MC, 03-Mar-2017, EUR 23.53), Underweight/Neutral, CD/J/K/M

Enel SpA (ENEI.MI, 03-Mar-2017, EUR 4.13), Overweight/Neutral, A/CD/D/E/FB/J/K/L/M/N/T

Italgas (IG.MI, 03-Mar-2017, EUR 3.83), Overweight/Neutral, A/CD/D/J/L

Pennon (PNN.L, 03-Mar-2017, GBp 878), Underweight/Neutral, CD/D/FA/J/K/L/M/N

Red Electrica (REE.MC, 03-Mar-2017, EUR 17.35), Underweight/Neutral, E/J/K/L/M

Redes Energeticas Nacionais (RENE.LS, 03-Mar-2017, EUR 2.64), Overweight/Neutral, CD/D/E/J/K/L/M/N

Snam (SRC.MI, 03-Mar-2017, EUR 3.86), Overweight/Neutral, A/CD/D/E/J/K/L/M/N/T

Other Material Conflicts: A current employee of Barclays will be leaving the bank to become Chief Financial Officer of Snam from the effective date of the demerger of Italgas S.p.A from Snam

SSE Plc. (SSE.L, 03-Mar-2017, GBp 1539), Overweight/Neutral, A/B/CD/D/E/J/K/L/M/N

Suez (SEVI.PA, 03-Mar-2017, EUR 13.89), Equal Weight/Neutral, A/CD/D/FA/J/K/L/M/N

IMPORTANT DISCLOSURES CONTINUED

Terna (TRN.MI, 03-Mar-2017, EUR 4.45), Overweight/Neutral, CD/D/J/K/L/M

United Utilities (UU.L, 03-Mar-2017, GBp 981), Equal Weight/Neutral, D/FA/J/K/L/M/N

Veolia (VIE.PA, 03-Mar-2017, EUR 16.26), Overweight/Neutral, A/CD/D/E/FA/J/K/L/M/N

Prices are sourced from Thomson Reuters as of the last available closing price in the relevant trading market.

Disclosure Legend:

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D: Barclays Bank PLC and/or an affiliate has received compensation for investment banking services from this issuer in the past 12 months.

E: Barclays Bank PLC and/or an affiliate expects to receive or intends to seek compensation for investment banking services from this issuer within the next 3 months.

FA: Barclays Bank PLC and/or an affiliate beneficially owns 1% or more of a class of equity securities of this issuer, as calculated in accordance with US regulations.

FB: Barclays Bank PLC and/or an affiliate beneficially owns a long position of more than 0.5% of a class of equity securities of this issuer, as calculated in accordance with EU regulations.

FC: Barclays Bank PLC and/or an affiliate beneficially owns a short position of more than 0.5% of a class of equity securities of this issuer, as calculated in accordance with EU regulations.

GD: One of the analysts on the fundamental credit coverage team (or a member of his or her household) has a financial interest in the debt or equity securities of this issuer.

GE: One of the analysts on the fundamental equity coverage team (or a member of his or her household) has a financial interest in the debt or equity securities of this issuer.

H: This issuer beneficially owns more than 5% of any class of common equity securities of Barclays PLC.

I: Barclays Bank PLC and/or an affiliate is party to an agreement with this issuer for the provision of financial services to Barclays Bank PLC and/or an affiliate.

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N: This issuer is, or during the past 12 months has been, a non-investment banking client (non-securities related services) of Barclays Bank PLC and/or an affiliate.

O: Not in use.

P: A partner, director or officer of Barclays Capital Canada Inc. has, during the preceding 12 months, provided services to the subject company for remuneration, other than normal course investment advisory or trade execution services.

Q: Barclays Bank PLC and/or an affiliate is a Corporate Broker to this issuer.

R: Barclays Capital Canada Inc. and/or an affiliate has received compensation for investment banking services from this issuer in the past 12 months.

S: This issuer is a Corporate Broker to Barclays PLC.

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U: The equity securities of this Canadian issuer include subordinate voting restricted shares.

V: The equity securities of this Canadian issuer include non-voting restricted shares.

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Guide to the Barclays Fundamental Equity Research Rating System:

Our coverage analysts use a relative rating system in which they rate stocks as Overweight, Equal Weight or Underweight (see definitions below) relative to other companies covered by the analyst or a team of analysts that are deemed to be in the same industry (the "industry coverage universe").

IMPORTANT DISCLOSURES CONTINUED

In addition to the stock rating, we provide industry views which rate the outlook for the industry coverage universe as Positive, Neutral or Negative (see definitions below). A rating system using terms such as buy, hold and sell is not the equivalent of our rating system. Investors should carefully read the entire research report including the definitions of all ratings and not infer its contents from ratings alone.

Stock Rating

Overweight - The stock is expected to outperform the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

Equal Weight - The stock is expected to perform in line with the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

Underweight - The stock is expected to underperform the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

Rating Suspended - The rating and target price have been suspended temporarily due to market events that made coverage impracticable or to comply with applicable regulations and/or firm policies in certain circumstances including where the Investment Bank of Barclays Bank PLC is acting in an advisory capacity in a merger or strategic transaction involving the company.

Industry View

Positive - industry coverage universe fundamentals/valuations are improving.

Neutral - industry coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.

Negative - industry coverage universe fundamentals/valuations are deteriorating.

Below is the list of companies that constitute the "industry coverage universe":

European Utilities

Centrica Plc. (CNA.L)	Drax Group Plc. (DRX.L)	E.ON (EONGn.DE)
Electricite de France (EDF.PA)	Enagas SA (ENAG.MC)	Enel SpA (ENEL.MI)
Innogy SE (IGY.DE)	Italgas (IG.MI)	National Grid Plc (NG.L)
Pennon (PNN.L)	Red Electrica (REE.MC)	Redes Energeticas Nacionais (RENE.LS)
RWE (RWE.G.DE)	Severn Trent (SVT.L)	Snam (SRG.MI)
SSE Plc. (SSE.L)	Suez (SEVI.PA)	Terna (TRN.MI)
Uniper SE (UN01.DE)	United Utilities (UU.L)	Veolia (VIE.PA)

Distribution of Ratings:

Barclays Equity Research has 1775 companies under coverage.

40% have been assigned an Overweight rating which, for purposes of mandatory regulatory disclosures, is classified as a Buy rating; 61% of companies with this rating are investment banking clients of the Firm; 77% of the issuers with this rating have received financial services from the Firm.

41% have been assigned an Equal Weight rating which, for purposes of mandatory regulatory disclosures, is classified as a Hold rating; 49% of companies with this rating are investment banking clients of the Firm; 74% of the issuers with this rating have received financial services from the Firm.

15% have been assigned an Underweight rating which, for purposes of mandatory regulatory disclosures, is classified as a Sell rating; 37% of companies with this rating are investment banking clients of the Firm; 62% of the issuers with this rating have received financial services from the Firm.

Guide to the Barclays Research Price Target:

Each analyst has a single price target on the stocks that they cover. The price target represents that analyst's expectation of where the stock will trade in the next 12 months. Upside/downside scenarios, where provided, represent potential upside/potential downside to each analyst's price target over the same 12-month period.

Top Picks:

Barclays Equity Research's "Top Picks" represent the single best alpha-generating investment idea within each industry (as defined by the relevant "industry coverage universe"), taken from among the Overweight-rated stocks within that industry. Barclays Equity Research publishes "Top Picks" reports every quarter and analysts may also publish intra-quarter changes to their Top Picks, as necessary. While analysts may highlight other Overweight-rated stocks in their published research in addition to their Top Pick, there can only be one "Top Pick" for each industry. To view the current list of Top Picks, go to the Top Picks page on Barclays Live (<https://live.barcap.com/go/keyword/TopPicks>).

To see a list of companies that comprise a particular industry coverage universe, please go to <https://publicresearch.barclays.com>.

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IMPORTANT DISCLOSURES CONTINUED

E.ON (EOAN GY / EONGn.DE)

EUR 7.48 (03-Mar-2017)

Stock Rating

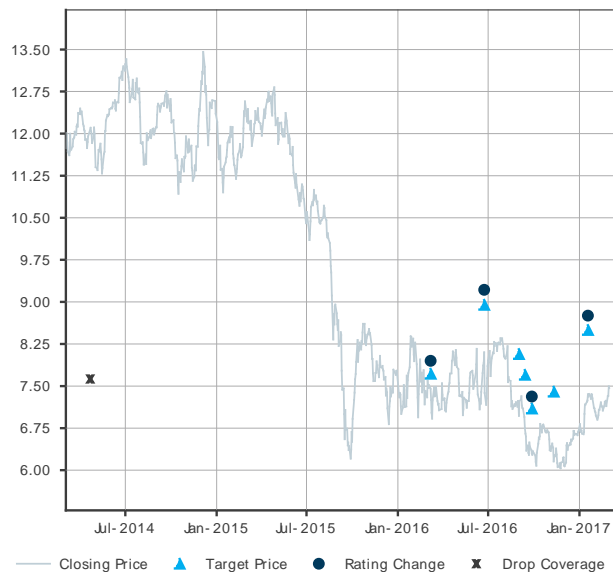
OVERWEIGHT

Industry View

NEUTRAL

Rating and Price Target Chart - EUR (as of 03-Mar-2017)

Currency=EUR



Publication Date	Closing Price	Rating	Adjusted Price Target
18-Jan-2017	7.35	Overweight	8.50
10-Nov-2016	6.16		7.40
27-Sep-2016	6.30	Equal Weight	7.10
13-Sep-2016	6.75		7.70
01-Sep-2016	7.02		8.07
23-Jun-2016	8.16	Overweight	8.95
07-Mar-2016	7.51	Equal Weight	7.72
15-Apr-2014	11.83	Coverage Dropped	

Source: Thomson Reuters, Barclays Research

Historical stock prices and price targets may have been adjusted for stock splits and dividends.

Source: IDC, Barclays Research

[Link to Barclays Live for interactive charting](#)

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FB: Barclays Bank PLC and/or an affiliate beneficially owns a long position of more than 0.5% of a class of equity securities of E.ON, as calculated in accordance with EU regulations.

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Valuation Methodology: We value E.On on a SOTP basis. Our SOTP is DCF-based for Customer Solutions, Renewables and Preussen Elektra (German Nuclear). We value Energy Networks on a RAB basis, including the NPV of future outperformance expectations as well as a terminal premium to RAB. In expectation of a final nuclear deal with the German government, we deconsolidate €8bn of waste-and-storage provisions from 2017 onwards. We include E.ON's current 46.65% of Uniper as our fair value, For foreign currencies we use the average YTD rate weighted by the spot rate for the remainder of the year. We mark-to market all wholesale commodity prices for their length of their liquid forward curves. Post this mark-to-market period for German power we assume a €5/MWh long-term baseload clean dark spread (equals historical ave); with a modest uplift €7/MWh in 2021 when the nuclear phase out in Germany should tighten supply.

Risks which May Impede the Achievement of the Barclays Research Valuation and Price Target: E.On is exposed to wholesale energy commodity prices, interest rates, regulatory and political intervention/risks, economic factors, corporate activity & competition. Our downside risk includes headwinds in UK& German retail as well as for US renewables. Our upside risk is a successful outcome of the Nuclear Fuel Tax challenge and E.ON's ability to deliver on cost savings.

Other Material Conflicts: The CEO of E.ON's Climate & Renewables division is the brother of the lead analyst covering this issuer.

IMPORTANT DISCLOSURES CONTINUED

Innogy SE (IGY GY / IGY.DE)

EUR 33.91 (03-Mar-2017)

Stock Rating

EQUAL WEIGHT

Industry View

NEUTRAL

Rating and Price Target Chart - EUR (as of 03-Mar-2017)

Currency=EUR



Publication Date	Closing Price	Rating	Adjusted Price Target
16-Nov-2016	31.98	Equal Weight	33.00

Source: Thomson Reuters, Barclays Research

Historical stock prices and price targets may have been adjusted for stock splits and dividends.

Source: IDC, Barclays Research

[Link to Barclays Live for interactive charting](#)

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D: Barclays Bank PLC and/or an affiliate has received compensation for investment banking services from Innogy SE in the past 12 months.

J: Barclays Bank PLC and/or an affiliate is a liquidity provider and/or trades regularly in the securities by Innogy SE and/or in any related derivatives.

K: Barclays Bank PLC and/or an affiliate has received non-investment banking related compensation (including compensation for brokerage services, if applicable) from Innogy SE within the past 12 months.

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N: Innogy SE is, or during the past 12 months has been, a non-investment banking client (non-securities related services) of Barclays Bank PLC and/or an affiliate.

Valuation Methodology: We value Innogy on a SOTP basis. Our SOTP is DCF-based for Retail and Renewables. We value Energy Networks on a RAB basis, including the NPV of future outperformance expectations as well as a terminal premium to RAB. For foreign currencies we use the average YTD rate weighted by the spot rate for the remainder of the year. We mark-to market all wholesale commodity prices for their length of their liquid forward curves. Post this mark-to-market period for German power we assume a €5/MWh long-term baseload clean dark spread (equals historical ave); with a modest uplift €7/MWh in 2021 when the nuclear phase out in Germany should tighten supply.

Risks which May Impede the Achievement of the Barclays Research Valuation and Price Target: Innogy is exposed to wholesale energy commodity prices, interest rates, regulatory and political intervention/risks, economic factors, corporate activity & competition. The main downside risks to our valuation are a further depreciation of sterling versus the euro, and a slower rebound in the UK retail business than we are assuming. The main upside risk is faster growth in Renewables than we are assuming

IMPORTANT DISCLOSURES CONTINUED

RWE (RWE GY / RWE.G.DE)

EUR 14.01 (03-Mar-2017)

Stock Rating

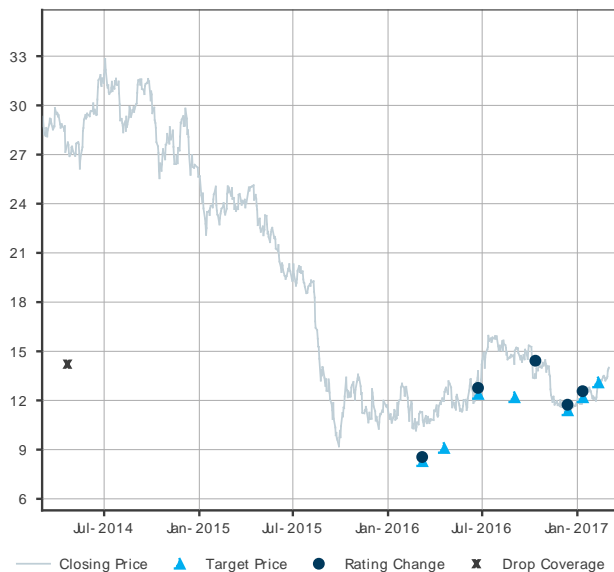
EQUAL WEIGHT

Industry View

NEUTRAL

Rating and Price Target Chart - EUR (as of 03-Mar-2017)

Currency=EUR



Publication Date	Closing Price	Rating	Adjusted Price Target
10-Feb-2017	12.90		13.10
11-Jan-2017	12.23	Equal Weight	12.20
13-Dec-2016	11.38	Underweight	11.40
12-Oct-2016	13.59	Rating Suspended	
01-Sep-2016	14.23		12.20
23-Jun-2016	13.80	Equal Weight	12.40
18-Apr-2016	11.97		9.10
07-Mar-2016	11.29	Underweight	8.30
15-Apr-2014	28.44	Coverage Dropped	

Source: Thomson Reuters, Barclays Research

Historical stock prices and price targets may have been adjusted for stock splits and dividends.

Source: IDC, Barclays Research

[Link to Barclays Live for interactive charting](#)

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J: Barclays Bank PLC and/or an affiliate is a liquidity provider and/or trades regularly in the securities by RWE and/or in any related derivatives.

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Valuation Methodology: We value RWE on a SOTP basis. Our valuation is DCF based for European Generation assets with an asset-related WACC used depending on asset type and region. Trading is valued on an EV/EBITDA multiple basis, for Innogy we are using our fair value assumptions. For foreign currencies we use the average YTD rate weighted by the spot rate for the remainder of the year. We mark to market all wholesale commodity prices for the length of their liquid forward curves. Post this period we assume a modest clean dark spread recovery in Germany to €5/MWh in 2020 and €7/MWh in 2021 and beyond as we see the German power market tightening when Nuclear capacity comes offline and announced coal closures materialize (>8GW). For the UK we assume a modest £3/MWh clean spark spread. For capacity payments in the UK we assume £6.95/kW for 2017/18. For the years 2018/19 and 2019/20 prices are determined at £19.4/kW and £18/kW, respectively. The latest 8 December 2016 auction determined a £22.5/kW strike price for 2020/21. For 2021/2022 and 2022/23 we assume £30/kW and £25/kW from 2023/24 onwards.

Risks which May Impede the Achievement of the Barclays Research Valuation and Price Target: RWE is exposed to wholesale energy commodity prices, interest rates, regulatory and political intervention/risks, economic factors, corporate activity & competition

IMPORTANT DISCLOSURES CONTINUED

Uniper SE (UN01 GY / UN01.DE)

EUR 13.50 (03-Mar-2017)

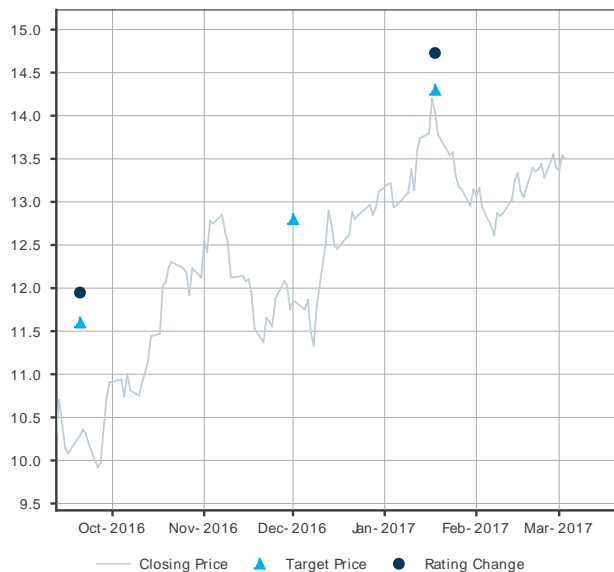
Stock Rating

EQUAL WEIGHT

Industry View

NEUTRAL

Rating and Price Target Chart - EUR (as of 03-Mar-2017)



Currency=EUR

Publication Date	Closing Price	Rating	Adjusted Price Target
18-Jan-2017	14.05	Equal Weight	14.30
01-Dec-2016	11.86	Overweight	12.80
20-Sep-2016	10.29	Overweight	11.60

Source: Thomson Reuters, Barclays Research

Historical stock prices and price targets may have been adjusted for stock splits and dividends.

Source: IDC, Barclays Research

[Link to Barclays Live for interactive charting](#)

A: Barclays Bank PLC and/or an affiliate has been lead manager or co-lead manager of a publicly disclosed offer of securities of Uniper SE in the previous 12 months.

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N: Uniper SE is, or during the past 12 months has been, a non-investment banking client (non-securities related services) of Barclays Bank PLC and/or an affiliate.

Valuation Methodology: We value Uniper on a SOTP basis. Our valuation is DCF based for European Generation assets with an asset-related WACC used depending on asset type and region. Global Commodities is valued on an EV/EBITDA multiple basis, using different multiples for Gas Midstream, Yushno Russkoje, pipeline participations and power trading. Uniper's International business consists mainly of Unipro, a listed entity for which' valuation we are using the current market capitalisation of 100% (Uniper holds a 83.7% stake in the business, accounted for in minorities) with its Brazilian business valued at EV/EBITDA multiples. For foreign currencies we use the average YTD rate weighted by the spot rate for the remainder of the year. We mark to market all wholesale commodity prices for the length of their liquid forward curves. Post this period we assume a modest clean dark spread recovery in Germany to €5/MWh in 2020 and €7/MWh in 2021 and beyond as we see the German power market tightening when Nuclear capacity comes offline and announced coal closures materialize (>8GW). FFor the UK we assume a modest £3/MWh clean spark spread. For capacity payments in the UK we assume £6.95/kW for 2017/18. For the years 2018/19 and 2019/20 prices are determined at £19.4/kW and £18/kW, respectively. The latest 8 December 2016 auction determined a £22.5/kW strike price for 2020/21. For 2021/2022 and 2022/23 we assume £30/kW and £25/kW from 2023/24 onwards.

Risks which May Impede the Achievement of the Barclays Research Valuation and Price Target: Uniper is exposed to wholesale energy commodity prices, interest rates, regulatory and political intervention/risks, economic factors, corporate activity & competition.

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