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2007 ANALYST REPORTS

Goldman Sachs

Europe: Utilities

CEZ, PPC, REE & RWE down to Sell; Biffa, E.ON & SRG now Neutral

Downgrades to Sell from Neutral: CEZ, PPC, Red Electrica & RWE

In our view, RWE shares are currently discounting high power prices for the long term and some element of free carbon forever; CEZ is also discounting high power prices and a potential headwind from local currency appreciation. In our view, PPC's shares fully reflect recent tariff increases and the prospect for company restructuring. We also believe that REE's share price fully reflects the potential for higher capex and returns over the longer term.

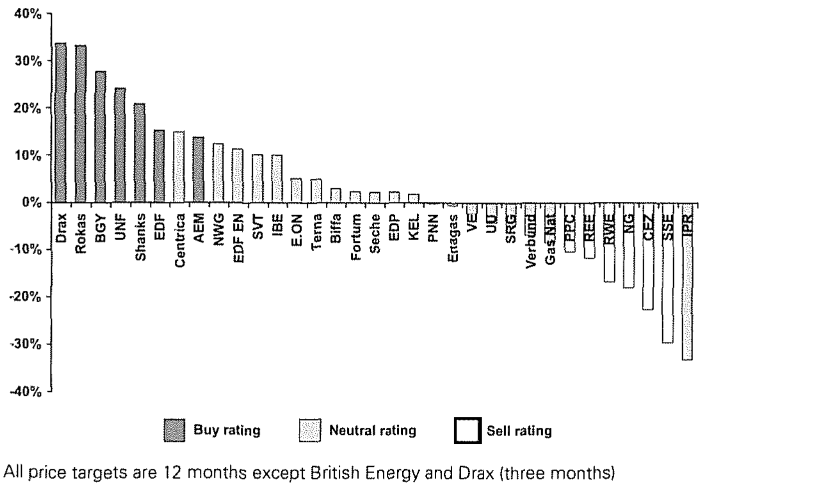
Downgrade EON and Biffa to Neutral from Buy, upgrade Snam to Neutral from Sell

We are removing E.ON and Biffa from our Buy List as the shares are now trading close to our 12-month price targets of €152 for E.ON and 337p for Biffa. We are also upgrading Snam Rete Gas to Neutral from Sell as the shares are now trading within 5% of our new 12-month RAB/SOTP-based price target of €4.25 (from €4.10).

Estimate and price target changes across the board

We have rolled-forward our price targets to year-end 2008. Our earnings and price targets are also updated for higher coal prices, inclusion of bid premia and year-end results in some cases.

European Utilities ratings and potential upside/downside to price targets



All price targets are 12 months except British Energy and Drax (three months)

Source: Goldman Sachs Research estimates

ACTION

Conviction ideas:

Conviction Ideas	Rating	Price target	% upside / (downside)
AEM	Buy	3.4	14%
Union Fenosa	Buy	57.0	24%
British Energy	Buy	680	29%
SSE	Sell	1,157	-28%

Rating changes:

	New rating	Old rating		New price target	Share price	Upside/ Downside
RWE	Sell	Neutral	€	80	94.79	-16%
REE	Sell	Neutral	€	38	43.96	-14%
PPC	Sell	Neutral	€	32.5	36.90	-12%
CEZ	Sell	Neutral	Kc	1,100	1,395	-21%
Snam	Neutral	Sell	€	4.25	4.44	-4%
Biffa	Neutral	Buy	£	337	323	4%
E.ON	Neutral	Buy	€	152	144	6%

All price targets are 12 months except British Energy (3 months)

Sources: Goldman Sachs Research estimates.

Related research: *2008 outlook: Energy Commodities, M&A and Environmental policies in focus*, December 17, 2007

Coverage view: Neutral

Goldman Sachs is acting as financial advisor to Gaz de France in an announced strategic transaction. See the Financial Advisory Disclosure section of this document for important disclosures about transactions in which The Goldman Sachs Group, Inc. or an affiliate is acting as financial advisor.

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Table of contents

The prices in the body of this report are based on the market close of December 13, 2007.

Summary of Utilities price target and estimate changes

Exhibit 1: Price target revisions (forecast period rolled forward to end-2008E, in local currency)

Stock	New Rating	Old Rating	New 12-month price target	Previous 12-month price target	% change	Share price	Potential upside / (downside)
EDF	Buy	Buy	94	92	2.2%	82	15%
Suez	NR	NR	--	--	n.a.	45	n.a.
Veolia Environnement	Neutral	Neutral	61.5	59.1	4.1%	61	0%
Séché Environnement	Neutral	Neutral	124	122	1.5%	121	2%
E.ON	**Neutral**	**Buy**	**152**	**145**	**4.6%**	**144**	**6%**
RWE	**Sell**	**Neutral**	**80**	**80**	**-0.4%**	**95**	**-16%**
Verbund	Neutral	Neutral	45	42	7.1%	49	-8%
Fortum	Neutral	Neutral	30	29	3.0%	30	1%
AEM	Buy**	Buy**	3.40	3.25	4.6%	3.0	14%
Enel	NR	NR	--	--	n.a.	8	n.a.
Snam RG	**Neutral**	**Sell**	**4.25**	**4.10**	**3.7%**	**4.4**	**-4%**
Terna	Neutral	Neutral	2.85	2.68	6.3%	2.7	4%
EDP	Neutral	Neutral	4.70	4.30	9.3%	4.5	4%
Endesa	NR	NR	--	--	n.a.	37	n.a.
Iberdrola	Neutral	Neutral	12.0	11.6	3.4%	10.6	13%
Union Fenosa	Buy**	Buy**	57	54.0	5.6%	45.8	24%
Gas Natural	Neutral	Neutral	39	36.0	8.3%	41.5	-6%
Enagas	Neutral	Neutral	21	18.5	13.5%	21.0	0%
REE	**Sell**	**Neutral**	**38**	**34**	**11.8%**	**44.0**	**-14%**
PPC	**Sell**	**Neutral**	**32.5**	**30**	**8.3%**	**36.9**	**-12%**
CEZ	**Sell**	**Neutral**	**1100**	**1250**	**-12.0%**	**1395**	**-21%**
British Energy	Buy**	Buy**	680	678	0.3%	529	29%
Centrica	Neutral	Neutral	427	417	2.4%	364	17%
Drax	Buy	Buy	938	876	7.1%	662	42%
International Power	Neutral	Neutral	310	242	28.1%	451	-31%
National Grid	Sell	Sell	689	670	2.8%	821	-16%
Scottish & Southern	Sell**	Sell**	1,157	1,167	-0.9%	1607	-28%
Kelda	Neutral	Neutral	1,090	1,090	0.0%	1070	2%
Northumbrian Water	Neutral	Neutral	374	321	16.5%	334	12%
Pennon	Neutral	Neutral	654	584	12.0%	644	2%
Severn Trent	Neutral	Neutral	1,684	1,478	13.9%	1500	12%
United Utilities	Neutral	Neutral	753	621	21.2%	757	0%
Biffa	**Neutral**	**Buy**	**337**	**335**	**0.7%**	**323**	**4%**
Shanks	Buy	Buy	281	279	0.7%	216	30%
Acciona	NR	NR	--	--	n.a.	224	n.a.
EDF Energies Nouvelles	Neutral	Neutral	57	52.0	9.6%	49.0	16%
Rokas	Buy	Buy	26	25.0	4.0%	19.3	35%

All timeframes are 12 months except British Energy and Drax (three months)

** denotes Conviction List membership

Source: Goldman Sachs Research estimates.

Exhibit 2: Price target methodology and risks

(local currency)

Company	Currency	Share price	Price Target	Rating	Price target methodology	Risks to Price Target	
Acciona	EUR	224.1	-	NR	-	-	-
AEM	EUR	2.98	3.40	Buy**	SOTP	Downside risk:	Falling power price and failure to deliver synergies
Biffa	GBP	323	337	Neutral	SOTP & P/E multiple	Risks:	Inability to capture significant growth and a lack of consolidation
British Energy	GBP	529	680	Buy**	DCF	Downside risk:	Lower power prices; further output losses
Centrica	GBP	364	427	Neutral	SOTP	Risks:	Lower/higher supply margins; further customer losses
CEZ	CZK	1395	1100	Sell	DCF	Upside risk:	Fall/rise in power prices, inability to execute regearing and CO_2 allowances allocation
Drax	GBP	662	938	Buy	DCF	Downside risk:	Lower power prices and higher coal prices
E.ON	EUR	143.5	152	Neutral	SOTP	Risks:	Lower commodity prices, greater political risk and/or value destruction through M&A.
EDF	EUR	81.79	94	Buy	SOTP	Downside risk:	Downside: Lack of tariff increases in France; lower market prices for European power.
EDF Energies Nouvelles	EUR	48.96	57	Neutral	SOTP	Risks:	Delays in the execution of projects; unexpected changes in renewables incentives/regulation
EDP	EUR	4.52	4.70	Neutral	SOTP	Risks:	Failure to grow in renewables; higher/lower wholesale electricity prices
Enagas	EUR	21.04	21	Neutral	DCF	Risks:	Slower demand growth and higher interest rates; faster demand growth and lower interest rates
Endesa	EUR	36.73	-	NR	-	-	-
Enel	EUR	8.21	-	NR	-	-	-
Fortum	EUR	29.68	30	Neutral	SOTP	Risks:	Lower/higher than expected Nordic power prices, Russian re-investment risk
Gas Natural	EUR	41.45	39	Neutral	SOTP	Risks:	Regulatory changes in gas distribution; M&A developments
Iberdrola	EUR	10.61	12.00	Neutral	SOTP	Risks:	Failure to deliver growth in renewables, tougher regulation, fall in wholesale prices
International Power	GBP	451	310	Neutral	SOTP	Risks:	Recovery in US power prices and growth in project development is quicker than anticipated
Kelda	GBP	1,070	1,090	Neutral	Bid price	Risks:	Duration of return spread (premium to RAV) and a counter bid / lack of bid from private equity / infrastructure fund
National Grid	GBP	821	689	Sell	RAV based-SOTP	Upside risk:	Better disposal prices; higher RAV bid premia
Northumbrian Water	GBP	334	374	Neutral	RAV & bid premium	Risks:	Duration of return spread (premium to RAV) and a bid from private equity / infrastructure fund
Pennon	GBP	644	654	Neutral	RAV & bid premium	Risks:	Duration of return spread (premium to RAV) and a bid from private equity / infrastructure fund
Public Power Corporation	EUR	37	33	Sell	SOTP	Upside risk:	Faster or slower tariff increases; speed of restructuring
REE	EUR	43.96	38	Sell	DCF	Upside risk:	Falling/rising interest rates; higher/lower remuneration and investments approved
Rokas	EUR	19.3	26	Buy	SOTP	Downside risk:	Failure to obtain the required regulatory permits on time; unexpected changes in renewables regulations
RWE	EUR	94.79	80	Sell	SOTP	Upside risk:	A bid, value from gearing up, higher power prices/lower carbon
Scottish & Southern	GBP	1,607	1,157	Sell**	RAV & bid premium	Upside risk:	Higher power prices for longer; greater returns from growth capex
Séché Environnement	EUR	121	124	Neutral	SOTP & P/E multiple	Risks:	Acquisition of additional stake in Saur, lack of new water contract wins and operational risks
Severn Trent	GBP	1,500	1,684	Neutral	RAV & bid premium	Risks:	Duration of return spread (premium to RAV) and a bid from private equity / infrastructure fund
Shanks	GBP	216	281	Buy	SOTP & P/E multiple	Downside risk:	Operational factors and a lack of sector consolidation
Snam RG	EUR	4.44	4.25	Neutral	RAV based-SOTP	Risks:	Faster demand growth and lower interest rates
Suez	EUR	45.21	-	NR	-	-	-
Terna	EUR	2.73	2.85	Neutral	RAV based-SOTP	Risks:	Slower demand growth and higher interest rates; faster demand growth and lower interest rates
Union Fenosa	EUR	45.84	57	Buy**	SOTP	Downside risk:	Regulatory changes, fall in wholesale prices
United Utilities	GBP	757	753	Neutral	RAV & bid premium	Risks:	Duration of return spread (premium to RAV) and a bid from private equity / infrastructure fund
Veolia Environnement	EUR	61.20	61.5	Neutral	SOTP	Risks:	Continuation of strong growth momentum into the longer term; use of balance sheet
Verbund	EUR	49.00	45	Neutral	SOTP	Risks:	Energy commodities; balance sheet efficiency and M&A

All timeframes are 12 months except British Energy and Drax (three months)

** denotes Conviction List membership

Source: Goldman Sachs Research estimates.

Exhibit 3: Estimate revisions

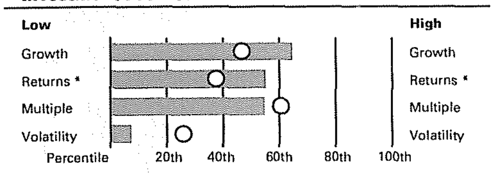
(local currency)

	2007E		2008E		2009E		Comments
	New	% chg.	New	% chg.	New	% chg.	
Suez	2.5	0%	2.7	0%	3.0	0%	Changes from rounding only
Veolia Environnement	2.3	-4%	2.9	5%	3.6	7%	Updated for recent acquisition, higher net debt (also interest charge) and minority
E.ON	7.6	-1%	9.6	-3%	10.8	-3%	Updated for higher price at which shares are bought back
RWE	5.4	0%	7.2	0%	8.8	0%	Change in working capital
Fortum	1.4	0%	1.7	1%	2.1	0%	Small increase in heating prices & higher DPS (balance sheet strength & lack of M&A)
Enel	0.6	0%	0.7	-5%	0.7	-4%	Higher coal prices
Terna	0.2	6%	0.2	11%	0.2	9%	Updated for acquisitions
EDP	0.2	0%	0.2	-5%	0.3	-2%	Higher coal prices
Endesa	2.3	0%	1.9	-1%	2.0	-2%	Higher coal prices
Iberdrola	0.5	0%	0.6	3%	0.6	0%	Higher coal prices
Union Fenosa	2.5	0%	3.1	0%	3.9	2%	Higher coal prices
Gas Natural	2.0	0%	2.4	11%	2.5	9%	New business plan and Mexico acquisition
CEZ	63.0	0%	80.4	-13%	100.5	-15%	Bringing FX from 27.7/25.0 in line with our economists's forecasts
British Energy	25.5	0%	44.1	1%	61.5	1%	Housekeeping on individual plant load factors; no material changes to output forecasts
International Power	25.4	3%	26.7	-5%	31.1	8%	Updated for 3Q results and higher coal price assumptions (negative impact)
Northumbrian Water	22.6	2%	23.0	2%	23.7	3%	Updated for 1H results
Pennon	30.2	-14%	40.9	-5%	45.2	-2%	Updated for 1H results - lower operating profits due to weather and higher interest
Severn Trent	86.9	-2%	100.2	-2%	116.8	0%	Updated for 1H results
United Utilities	56.0	15%	45.6	6%	49.6	12%	Updated for 1H results, announced special dividend and share consolidation
Acciona	8.3	0%	7.8	0%	10.4	-1%	Minor estimate changes following changes at Endesa

Source: Goldman Sachs Research estimates.

RWE (RWEG.DE): Downgrade to Sell from Neutral

Investment Profile: RWE



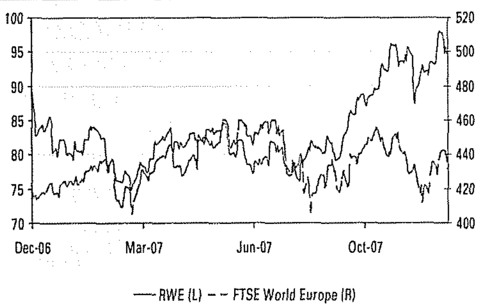
RWEG.DE

Europe Utilities Peer Group Average

* Returns = Return on Capital For a complete description of the investment profile measures please refer to the disclosure section of this document.

Key data				Current
Price (€)				94.69
12 month price target (€)				80.00
Upside/(downside) (%)				(16)
Market cap (€ mn)				52,719.8
Enterprise value (€ mn)				77,110.6
	12/06	12/07E	12/08E	12/09E
Revenue (€ mn) New	44,256.2	44,587.9	50,244.0	52,979.5
Revenue revision (%)	0.0	0.0	0.0	0.0
EBIT (€ mn) New	5,720.2	6,704.9	7,101.6	8,287.3
EBIT revision (%)	0.0	0.0	0.0	0.0
EPS (€) New	4.38	5.35	7.16	8.79
EPS (€) Old	4.38	5.35	7.18	8.82
EV/EBITDA (X)	9.0	8.8	8.6	7.4
P/E (X)	16.3	17.7	13.2	10.8
Dividend yield (%)	4.9	2.9	3.8	4.6
FCF yield (%)	32.0	1.0	(1.7)	12.9
CROCI (%)	7.6	7.1	7.4	8.0

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	15.7	18.8	6.7
Rel. to FTSE World Europe	21.0	30.7	9.1

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 12/13/2007 close.

Source of opportunity

We are downgrading RWE to Sell from Neutral as we believe the stock is currently discounting high power prices for the long term and some element of free carbon forever. We believe greater clarity from the EU in January will focus the market on the material medium-term carbon liability. In October, we upgraded our forecasts for the German power price to €65/MWh for 2008 based on higher coal forecasts. Although coal prices have remained relatively high, German forward power prices have held around the €60/MWh level. Were German power prices not to rise as expected, we see downside risks to earnings, primarily for 2009.

Catalyst

We expect RWE to provide among the strongest earnings growth in the pan-European utilities sector in 2008 with 16% EBITDA and 34% EPS growth driven primarily by higher power prices. Despite this growth, RWE is trading on a discount relative to the sector at 8.6x EV/EBITDA in 2008E and 13.2x P/E. We believe a discount is justified for RWE as medium-term earnings are not sustainable due to the carbon liability and to reflect increasing capex requirements. Were we to adjust earnings to reflect full cost of carbon emissions, our 2008 EBITDA would be 15% lower and our EPS would fall by 24%. Were we to correct earnings multiples for the full carbon costs, RWE would no longer look attractive on a sector relative basis (EV/EBITDA 2008 at 9.7x, P/E at 17.5x). We expect announcements from the EU on the guidelines for Phase III carbon trading at end-January to increase focus on RWE's medium-term carbon liability. Our assumptions across the sector are for no free allocations in Phase III.

Valuation

Our unchanged €80 12-month, SOTP-based price target for RWE is based on market prices for power of €65/MWh in 2008E fading to €60/MWh by 2010E, no free carbon from 2013E, and an EV for AWW of €6.9 bn.

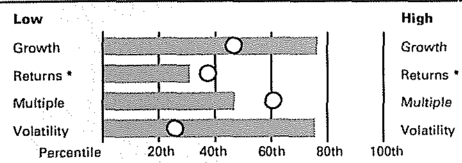
Key risks

The main risks to our view and price target are higher commodity prices, favourable regulatory intervention and better-than expected execution.

Source: Company data, Goldman Sachs Research estimates. FactSet

PPC (DEHr.AT): Downgrade to Sell from Neutral

Investment Profile: Public Power Corporation SA



DEHr.AT

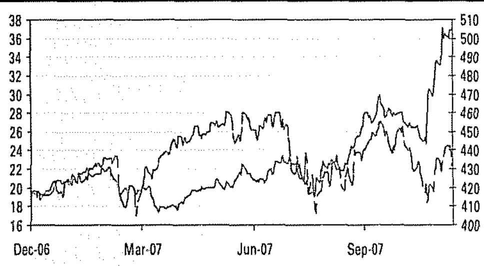
Europe Utilities Peer Group Average

* Returns = Return on Capital For a complete description of the investment profile measures please refer to the disclosure section of this document.

Key data	Current
Price (€)	36.90
12 month price target (€)	32.50
Upside/(downside) (%)	(12)
Market cap (€ mn)	8,560.8
Enterprise value (€ mn)	12,816.5

	12/06	12/07E	12/08E	12/09E
Revenue (€ mn)	4,787.5	5,087.9	5,758.9	6,264.4
EBIT (€ mn)	243.9	274.4	1,068.0	1,303.2
EPS (€)	0.44	0.40	2.82	3.47
EV/EBITDA (X)	11.5	16.6	8.3	7.4
P/E (X)	43.1	93.3	13.1	10.6
Dividend yield (%)	2.6	0.4	2.7	3.8
FCF yield (%)	(0.4)	(1.7)	(1.1)	(2.2)
CROCI (%)	7.2	6.6	10.4	10.8

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	64.3	73.2	88.7
Rel. to FTSE World Europe	71.8	90.6	92.8

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 12/13/2007 close.

Source: Company data, Goldman Sachs Research estimates, FactSet

Source of opportunity

We are downgrading Public Power Corporation to Sell from Neutral as we believe the share price has overreacted to the new business plan and recently *announced tariff increases. In our view,* the current share price is already discounting further tariff increases, some restructuring and CO_2 allowances from 2013, benefits which we believe are unlikely.

Catalyst

With supply tariff increases recently announced and major restructuring highly unlikely in our view, we believe the EU decision on CO_2 permits in *January could have a major impact on our valuation.*

Valuation

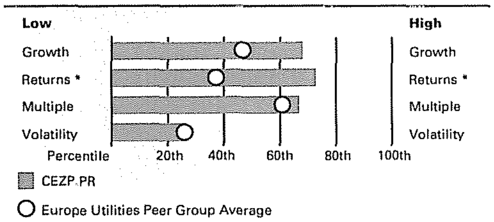
Despite increasing our 12-month SOTP-based target price to €32.5 from €30 as a result of rolling our valuation forward to end-2008, we still see 12% *potential* downside from current levels. Even in a more favourable scenario of 20% lower commodity prices, that would indicate a €35 target price, our SOTP *value would still imply* 5% *downside* for the shares.

Key risks

They key risks to our price target are changes to commodity prices, CO_2 *prices and allocations.* Our assumptions from 2013 onwards include no free-carbon allowances. A significantly different outcome from the EU regarding CO_2 *emissions in January could have a material impact on* our valuation. For example, a perpetual 50% free-carbon allowance would add €7 to our target price.

CEZ (CEZP.PR): Downgrade to Sell from Neutral

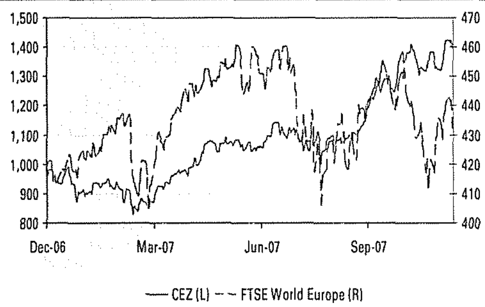
Investment Profile: CEZ



* Returns = Return on Capital For a complete description of the investment profile measures please refer to the disclosure section of this document

Key data				Current
Price (Kc)				1,395.00
12 month price target (Kc)				1,100.00
Upside/(downside) (%)				(21)
Market cap (Kc mn)				826,134.3
Enterprise value (Kc mn)				877,106.7
	12/06	12/07E	12/08E	12/09E
Revenue (Kc mn) New	**159,579.7**	**176,673.0**	**189,266.6**	**201,411.3**
Revenue revision (%)	0.0	0.0	(5.2)	(6.5)
EBIT (Kc mn) New	**40,064.3**	**50,219.9**	**61,096.4**	**72,123.1**
EBIT revision (%)	0.0	0.0	(11.4)	(13.3)
EPS (Kc) New	**46.77**	**62.96**	**80.38**	**100.48**
EPS (Kc) Old	46.77	62.96	92.09	118.04
EV/EBITDA (X)	8.3	11.9	9.9	8.4
P/E (X)	17.3	22.2	17.4	13.9
Dividend yield (%)	2.5	2.2	2.9	3.6
FCF yield (%)	4.3	3.8	5.0	5.8
CROCI (%)	12.7	12.2	13.3	14.4

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	26.6	29.9	41.3
Rel. to FTSE World Europe	38.5	55.5	53.4

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 12/13/2007 close.

Source of opportunity

We are downgrading CEZ to Sell from Neutral as we believe that the stock is currently discounting high power prices for the long term and that the local currency appreciation represents a negative headwind for the company.

Catalyst

We expect announcements from the EU on the guidelines for Phase III carbon trading at end-January to be the key catalyst for CEZ in the coming months. Our assumptions across the sector are for no free allocations in Phase III.

Valuation

We are reducing our 12-month DCF-based target price for CEZ to Kc1,100 from Kc1,250 as we align our €/Kc exchange rate to our Economists' forecasts and change it from 27.7 to 25.5 average for 2008 and to 25 beyond. We are cutting our estimate in Kc as a result. The appreciating currency is a negative for CEZ as its revenues in local currency, linked to German power prices (which are priced in €/MWh), shrink as a result of the currency appreciation – while its costs generally do not. CEZ shows 21% potential downside to our price target, based on long-term baseload power prices in Central Europe of €60 per MWh.

Key risks

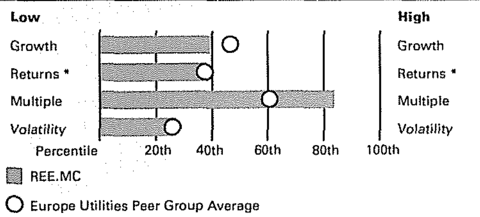
The key risk to our price target for CEZ is linked to changes in energy commodities. In a higher oil/coal price scenario (with 20% higher commodities and with power prices in Central Europe of €69 per MWh) CEZ's value could rise to Kc1,420 per share – yet this would only imply 2% upside from current levels. In a low-commodity scenario of €52 per MWh longer term power prices, we calculate a value for CEZ of only Kc850 per share.

We assume no free-carbon allocations over the longer term (post 2013). A 50% free carbon allocation forever would add c.Kc100 to our valuation: however we believe that the January statements from the EU regarding the proposal for Phase III carbon credits trading will lead to a general realisation that it is unlikely that companies will keep receiving free carbon over the longer term. Our 12-month DCF based target price is based on a 7.6% WACC, implying a long-term gearing of 20% at CEZ. In order to achieve that CEZ will need to carry out further capital returns or acquisitions, as its current D/(D+E) is only 8%.

Source. Company data, Goldman Sachs Research estimates, FactSet

Red Electrica (REE.MC): Downgrade to Sell from Neutral

Investment Profile: Red Electrica de Espana

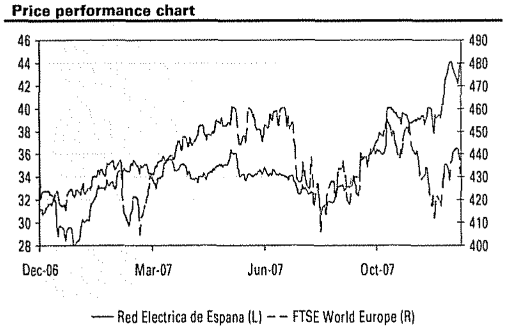


* Returns = Return on Capital. For a complete description of the investment profile measures please refer to the disclosure section of this document.

Key data	Current
Price (€)	43.96
12 month price target (€)	38.00
Upside/(downside) (%)	(14)
Market cap (€ mn)	5,946.5
Enterprise value (€ mn)	8,745.2

	12/06	12/07E	12/08E	12/09E
Revenue (€ mn)	954.1	1,025.9	1,105.1	1,183.8
EBIT (€ mn)	401.8	468.6	521.9	568.1
EPS (€)	1.48	1.73	1.99	2.14
EV/EBITDA (X)	10.2	12.1	11.4	10.7
P/E (X)	19.5	25.4	22.1	20.5
Dividend yield (%)	3.1	2.4	2.8	3.0
FCF yield (%)	(0.5)	(7.0)	(0.8)	(0.5)
CROCI (%)	8.3	8.1	8.3	8.4
CROCI/WACC (X)	1.6	1.4	1.5	1.5
EV/GCI (X)	1.0	1.2	1.2	1.1

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	29.8	30.4	23.7
Rel. to FTSE World Europe	35.7	43.5	26.5

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 12/13/2007 close.

Source of opportunity

We are downgrading REE to Sell from Neutral on valuation grounds. We believe that its share price performance in recent weeks indicates that the market has already fully reflected the news flow of potentially higher capex and higher returns at REE over the longer term.

Catalyst

We expect the Spanish Government to grant approval for the revised remuneration for Red Electrica at the end of December. Similarly we expect final approval of the new investments required in the Spanish electricity network for the 2007-2016 period to be a major event for the shares.

Valuation

We are increasing our DCF-based 12-month target price from €34 to €38 to reflect higher than previously expected IRRs on new investments (7.7% vs. our previous assumption of 7.0%). Despite this, we see 14% potential downside from the current share price. Our target price assumes that the existing tariffs for REE are cut by 10% in 2012: even assuming no tariff cut, the potential upside would only be 7%.

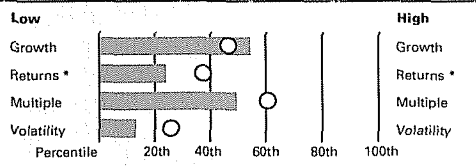
Key risks

An outcome different from our assumptions in terms of remuneration and investments represent the key upside risk to our target price. If we assume that existing tariffs for REE are not cut, this would add €13 per share to our valuation for REE, taking it to €47.

Source: Company data, Goldman Sachs Research estimates, FactSet

E.ON (EONG.DE): Downgrade to Neutral from Buy

Investment Profile: E.ON



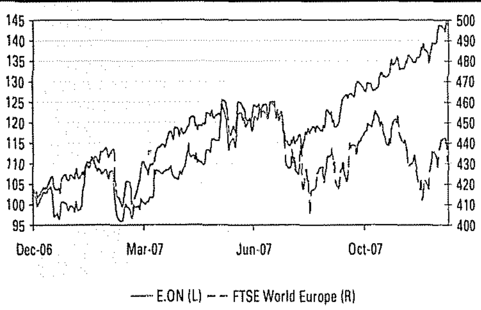
EONG.DE

Europe Utilities Peer Group Average

* Returns = Return on Capital For a complete description of the investment profile measures please refer to the disclosure section of this document

Key data				Current
Price (€)				143.85
12 month price target (€)				152.00
Upside/(downside) (%)				6
Market cap (€ mn)				95,548.4
Enterprise value (€ mn)				99,921.8
	12/06	12/07E	12/08E	12/09E
Revenue (€ mn) New	**67,759.0**	**69,035.4**	**77,096.0**	**82,448.2**
Revenue revision (%)	0.0	0.0	0.0	0.0
EBIT (€ mn) New	**7,744.0**	**8,279.5**	**10,173.6**	**11,588.0**
EBIT revision (%)	0.0	0.0	0.0	0.0
EPS (€) New	**6.65**	**7.57**	**9.61**	**10.82**
EPS (€) Old	6.65	7.67	9.87	11.11
EV/EBITDA (X)	6.0	8.9	8.1	7.9
P/E (X)	14.0	19.0	15.0	13.3
Dividend yield (%)	3.6	2.8	3.5	4.0
FCF yield (%)	8.6	(3.3)	(14.4)	(1.8)
CROCI (%)	5.6	6.3	6.7	6.8

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	15.2	26.1	41.7
Rel. to FTSE World Europe	20.5	38.7	44.9

Source: Company data, Goldman Sachs Research estimates. FactSet. Price as of 12/13/2007 close.

What happened

We are downgrading E.ON to Neutral from Buy as the stock is now within c.5% of our new 12-month SOTP-based price target of €152 (from €145). The shares are up 32.9% since being added to the List on April 3, 2007, vs. FTSE World Europe down 0.8%. Over 12 months, the shares are up 41.7% vs. the index up 4.3%.

Current view

In addition to commodity prices, we expect the main driver for E.ON in 2008 to be the further rollout of the €60 bn capex program through acquisition and organic capex. We see the 2007 full year results as an important event for E.ON as they are likely to provide further visibility on the pace of the capex deployment and the earnings growth expected from the investments. We expect E.ON to provide strong earnings growth in 2008 – we forecast EBITDA growth of 21% and clean EPS growth of 27% – and expect the shares to be supported by the €3.5 bn share buyback program. E.ON is relatively well positioned in terms of its carbon exposure due to its relatively low emissions and its low carbon intensity vs. its relevant market.

We have increased our 12-month price target from €145 to €152 to reflect the higher mark-to-market for E.ON's Gazprom stake and the roll forward of our forecasts to year-end 2008. The major risk to our price target for E.ON is lower commodity prices, political intervention and execution.

Source. Company data, Goldman Sachs Research estimates, FactSet.

Exhibit 4: Share price performance of E.ON versus peer group
Prices as of the close on December 13, 2007

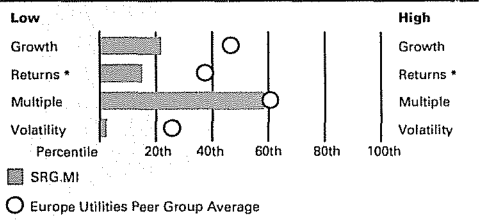
Company	Ticker	Primary analyst	Price currency	Price as of Dec 13, 2007	Price performance since Apr 3, 2007	3 month price performance	6 month price performance	12 month price performance
Europe Utilities Peer Group								
E.ON	**EONG.DE**	**Deborah Wilkens**	**€**	**143.85**	**32.9%**	**15.2%**	**26.1%**	**41.7%**
Acciona SA	ANA.MC	Matija Gergolet	€	224.10	29.8%	30.9%	16.3%	60.1%
AEM SpA	AEMI.MI	Matija Gergolet	€	2.98	6.8%	16.6%	3.6%	22.4%
Biffa Plc	BIFF.L	Jenny Ping	p	323.00	-8.0%	41.0%	12.9%	4.9%
British Energy	BGY.L	Andrew Mead	p	529.00	7.5%	5.7%	-1.4%	5.8%
C. Rokas S.A.	ARCr.AT	Matija Gergolet	€	19.30	-3.3%	1.6%	-3.3%	0.5%
Centrica	CNA.L	Andrew Mead	p	364.25	-7.4%	-3.6%	-0.1%	7.0%
CEZ	CEZP.PR	Matija Gergolet	Kc	1395.00	47.3%	26.6%	29.9%	41.3%
Drax Group Plc	DRX.L	Andrew Mead	p	662.00	-15.7%	7.0%	-12.3%	-19.4%
EDF	EDF.PA	Andrew Mead	€	81.79	29.4%	13.0%	18.0%	47.2%
EDF Energies Nouvelles S.A.	EEN.PA	Matija Gergolet	€	48.96	6.4%	-0.6%	11.1%	27.2%
Enagas	ENAG.MC	Matija Gergolet	€	21.04	9.1%	19.5%	14.8%	2.5%
Endesa SA	ELE.MC	Matija Gergolet	€	36.73	-8.2%	-8.2%	-8.2%	2.4%
Enel SpA	ENEI.MI	Matija Gergolet	€	8.21	0.0%	6.0%	-1.4%	4.5%
Energias de Portugal	EDP.LS	Matija Gergolet	€	4.52	8.7%	15.6%	10.8%	20.5%
Fortum	FUM1V.HE	Deborah Wilkens	€	29.68	34.8%	25.0%	29.0%	31.9%
Gas Natural	GAS.MC	Matija Gergolet	€	41.45	11.6%	12.0%	-5.7%	31.6%
Iberdrola SA	IBE.MC	Matija Gergolet	€	10.61	14.7%	11.1%	-3.4%	27.1%
International Power	IPR.L	Andrew Mead	p	450.75	9.6%	6.1%	5.2%	16.1%
Kelda	KEL.L	Jenny Ping	p	1070.00	9.4%	19.6%	10.2%	13.9%
National Grid	NG.L	Andrew Mead	p	820.50	0.6%	9.5%	13.2%	10.7%
Northumbrian Water Group	NWG.L	Jenny Ping	p	334.00	5.4%	-1.2%	7.1%	9.7%
Pennon	PNN.L	Jenny Ping	p	643.50	5.8%	6.2%	3.0%	17.8%
Public Power Corporation SA	DEHr.AT	Matija Gergolet	€	36.90	112.3%	64.3%	73.2%	88.7%
Red Electrica de Espana	REE.MC	Matija Gergolet	€	43.96	22.8%	29.8%	30.4%	23.7%
RWE	RWEG.DE	Deborah Wilkens	€	94.69	16.4%	15.7%	18.8%	6.7%
Scottish and Southern Energy	SSE.L	Andrew Mead	p	1607.00	1.6%	12.1%	10.8%	5.4%
Severn Trent	SVT.L	Jenny Ping	p	1500.00	2.6%	9.1%	1.5%	2.2%
Shanks Group	SKS.L	Jenny Ping	p	215.50	-20.2%	-4.6%	-18.7%	-10.4%
Snam Rete Gas SpA	SRG.MI	Matija Gergolet	€	4.44	-8.5%	-0.4%	1.7%	2.8%
Suez	LYOE.PA	Deborah Wilkens	€	45.21	11.6%	18.0%	13.5%	19.4%
Séché Environnement	CCHE.PA	Jenny Ping	€	120.99	-2.4%	-2.0%	-13.6%	-5.1%
Terna	TRN.MI	Matija Gergolet	€	2.73	-2.2%	6.1%	2.8%	4.3%
Union Fenosa SA	UNF.MC	Matija Gergolet	€	45.84	7.2%	19.3%	10.7%	16.3%
United Utilities	UU.L	Jenny Ping	p	756.50	-1.0%	11.1%	0.5%	-4.0%
Veolia Environnement	VIE.PA	Jenny Ping	€	61.20	9.0%	5.6%	6.4%	20.6%
Verbund	VERB.VI	Deborah Wilkens	€	49.00	45.1%	30.1%	32.0%	21.8%
FTSE World Europe				431.28	-0.8%	0.1%	-3.4%	4.3%

Note: This table shows movement in absolute share price and not total shareholder return.
Results presented should not and cannot be viewed as an indicator of future performance.

Source: FactSet, Quantum database.

Snam Rete Gas (SRG.MI): Upgrade to Neutral from Sell

Investment Profile: Snam Rete Gas SpA

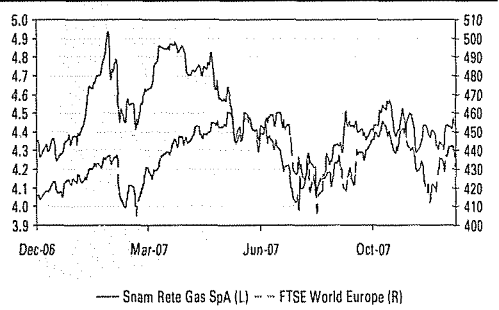


* Returns = Return on Capital. For a complete description of the investment profile measures please refer to the disclosure section of this document.

Key data	Current
Price (€)	4.44
12 month price target (€)	4.25
Upside/(downside) (%)	(4)
Market cap (€ mn)	8,678.9
Enterprise value (€ mn)	13,913.3

	12/06	12/07E	12/08E	12/09E
Revenue (€ mn)	1,789.0	1,815.3	1,911.6	2,004.1
EBIT (€ mn)	911.0	956.1	1,031.8	1,114.7
EPS (€)	0.24	0.25	0.26	0.28
EV/EBITDA (X)	8.7	9.6	9.3	9.1
P/E (X)	15.6	18.0	16.8	16.1
Dividend yield (%)	5.1	4.7	5.2	5.6
FCF yield (%)	4.3	2.5	(0.9)	(1.2)
CROCI (%)	5.5	5.3	5.3	5.3
CROCI/WACC (X)	1.1	0.8	0.8	0.8
EV/GCI (X)	0.6	0.7	0.7	0.7

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	(0.4)	1.7	2.8
Rel. to FTSE World Europe	4.1	11.9	5.1

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 12/13/2007 close.

Source: Company data, Goldman Sachs Research estimates, FactSet

What happened

We are upgrading Snam Rete Gas to Neutral from Sell as the shares are now trading within 5% of our new 12-month RAB/SOTP-based price target of €4.25 (from €4.10). Since being added to the Sell List on September 29, 2006, Snam's shares have risen 16% compared to FTSE World Europe Index.

Current view

We believe that the next major event for Snam RG will be in February when the company presents its FY2007 results, as well as an update on its capex plan. It could take the opportunity to increase again the proportion of development capex, which would fuel further growth in the short to medium term and add visibility to its long-term growth prospects. More normal winter temperatures (after last year's mild winter in Italy) would also lead to a significant increase year-on-year in gas usage, and as a consequence the higher volumes transported by the company would likely positively impact the P&L in the coming two quarters.

The main risk to our target price for Snam RG is a change in the Italian gas transmission regulation, which is not due for renewal until 2009. Higher or lower interest rates could also affect profitability, even though Snam has a partial hedge against interest rate changes.

Exhibit 5: Share price performance of Snam Rete Gas versus peer group
Prices as of the close on December 13, 2007

Company	Ticker	Primary analyst	Price currency	Price as of Dec 13, 2007	Price performance since Sep 29, 2006	3 month price performance	6 month price performance	12 month price performance
Europe Utilities Peer Group								
Snam Rete Gas SpA	**SRG.MI**	**Matija Gergolet**	**€**	**4.44**	**15.9%**	**-0.4%**	**1.7%**	**2.8%**
Acciona SA	ANA.MC	Matija Gergolet	€	224.10	86.8%	30.9%	16.3%	60.1%
AEM SpA	AEMI.MI	Matija Gergolet	€	2.98	39.9%	16.6%	3.6%	22.4%
Biffa Plc	BIFF.L	Jenny Ping	p	323.00	NA	41.0%	12.9%	4.9%
British Energy	BGY.L	Andrew Mead	p	529.00	-8.9%	5.7%	-1.4%	5.8%
C. Rokas S.A.	ARCr.AT	Matija Gergolet	€	19.30	6.3%	1.6%	-3.3%	0.5%
Centrica	CNA.L	Andrew Mead	p	364.25	12.0%	-3.6%	-0.1%	7.0%
CEZ	CEZP.PR	Matija Gergolet	Kc	1395.00	76.5%	26.6%	29.9%	41.3%
Drax Group Plc	DRX.L	Andrew Mead	p	662.00	-20.5%	7.0%	-12.3%	-19.4%
E.ON	EONG.DE	Deborah Wilkens	€	143.85	53.9%	15.2%	26.1%	41.7%
EDF	EDF.PA	Andrew Mead	€	81.79	86.7%	13.0%	18.0%	47.2%
EDF Energies Nouvelles S.A	EEN.PA	Matija Gergolet	€	48.96	NA	-0.6%	11.1%	27.2%
Enagas	ENAG.MC	Matija Gergolet	€	21.04	10.1%	19.5%	14.8%	2.5%
Endesa SA	ELE.MC	Matija Gergolet	€	36.73	9.5%	-8.2%	-8.2%	2.4%
Enel SpA	ENEI.MI	Matija Gergolet	€	8.21	14.0%	6.0%	-1.4%	4.5%
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International Power	IPR.L	Andrew Mead	p	450.75	44.0%	6.1%	5.2%	16.1%
Kelda	KEL.L	Jenny Ping	p	1070.00	22.9%	19.6%	10.2%	13.9%
National Grid	NG.L	Andrew Mead	p	820.50	22.9%	9.5%	13.2%	10.7%
Northumbrian Water Group	NWG.L	Jenny Ping	p	334.00	20.1%	-1.2%	7.1%	9.7%
Pennon	PNN.L	Jenny Ping	p	643.50	26.2%	6.2%	3.0%	17.8%
Public Power Corporation SA	DEHr.AT	Matija Gergolet	€	36.90	94.2%	64.3%	73.2%	88.7%
Red Electrica de Espana	REE.MC	Matija Gergolet	€	43.96	43.6%	29.8%	30.4%	23.7%
RWE	RWEG.DE	Deborah Wilkens	€	94.69	30.2%	15.7%	18.8%	6.7%
Scottish and Southern Energy	SSE.L	Andrew Mead	p	1607.00	21.9%	12.1%	10.8%	5.4%
Severn Trent	SVT.L	Jenny Ping	p	1500.00	3.5%	9.1%	1.5%	2.2%
Shanks Group	SKS.L	Jenny Ping	p	215.50	16.0%	-4.6%	-18.7%	-10.4%
Suez	LYOE.PA	Deborah Wilkens	€	45.21	30.4%	18.0%	13.5%	19.4%
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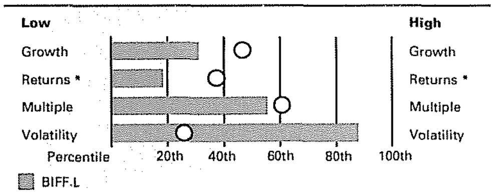
Terna	TRN.MI	Matija Gergolet	€	2.73	19.0%	6.1%	2.8%	4.3%
Union Fenosa SA	UNF.MC	Matija Gergolet	€	45.84	13.8%	19.3%	10.7%	16.3%
United Utilities	UU.L	Jenny Ping	p	756.50	7.2%	11.1%	0.5%	-4.0%
Veolia Environnement	VIE.PA	Jenny Ping	€	61.20	30.7%	5.6%	6.4%	20.6%
Verbund	VERB.VI	Deborah Wilkens	€	49.00	28.4%	30.1%	32.0%	21.8%
FTSE World Europe				431.28	10.0%	0.1%	-3.4%	4.3%

Note: This table shows movement in absolute share price and not total shareholder return.
Results presented should not and cannot be viewed as an indicator of future performance.

Source: FactSet, Quantum database.

Biffa (BIFF.L): Downgrade to Neutral from Buy

Investment Profile: Biffa Plc

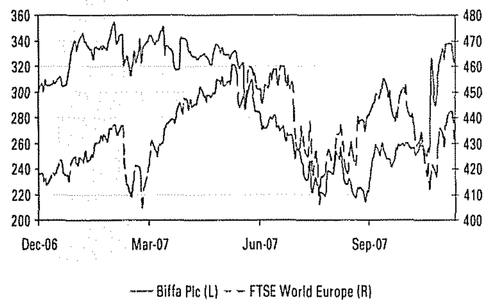


* Returns = Return on Capital For a complete description of the investment profile measures please refer to the disclosure section of this document.

Key data	Current
Price (p)	323
12 month price target (p)	337
Upside/(downside) (%)	4
Market cap (£ mn)	1,128.9
Enterprise value (£ mn)	1,550.3

	3/07	3/08E	3/09E	3/10E
Revenue (£ mn)	742.7	809.0	872.0	939.7
EBIT (£ mn)	90.7	98.6	104.2	108.7
EPS (p)	14.08	15.20	16.92	18.11
EV/EBITDA (X)	9.8	9.4	8.9	8.4
P/E (X)	21.8	21.2	19.1	17.8
Dividend yield (%)	2.1	2.0	2.3	2.4
FCF yield (%)	4.1	3.2	4.3	4.4
CROCI (%)	9.6	8.4	8.9	8.8
CROCI/WACC (X)	1.4	1.2	1.2	1.2
EV/GCI (X)	1.0	1.0	0.9	0.9

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	41.0	12.9	4.9
Rel. to FTSE World Europe	40.9	16.9	0.5

Source: Company data, Goldman Sachs Research estimates FactSet. Price as of 12/13/2007 close.

What happened

We are removing Biffa from our Buy List as the shares are now trading close to our 12-month price target of 335p. We now rate the shares Neutral. Since being added to the Buy List on April 16, 2007, Biffa's shares have risen 1.3%, vs. FTSE World Europe down 3.2%. Over the same period our mid and small cap coverage universe fell 19% and the DJ Stoxx Utilities Index rose 11%. Over 12 months the shares are up 4.9%, vs. FTSE World Europe up 4.3%.

Current view

Fundamentally, we continue to believe Biffa is well placed in the UK waste market to take advantage of the large investment programme for waste treatment infrastructure, especially with the prospect of a new CEO, who could look to alter the existing strategy/asset mix of the group. From an M&A perspective, we believe further consolidation involving Biffa remains possible (despite its recent rejection of a 330p offer from Montagu and HgCapital). However, the fundamental operational improvement and the delivery of growth could take some time. In addition, while we would not rule out a revised bid from Montagu/HgCapital or possible interest from other players, we believe the probability of a bid is fairly reflected in the current share price. Furthermore, with less than 5% potential upside to our price target, we believe there are more attractive opportunities elsewhere in the sector.

Our 12-month price target remains broadly unchanged at 337p (from 335p), and is based on our long-term SOTP (70% weighting) and on our *short-term multiple-based approach* (30% weighting). Using our SOTP valuation alone (long-term fundamental approach), we calculate a value of 324p per share pre consolidation synergies, and 361p per share including 50% of possible consolidation synergies.

The key risks to our price target are operational performance and further M&A involving Biffa.

Source: Company data, Goldman Sachs Research estimates, FactSet.

Exhibit 6: Share price performance of Biffa versus peer group
Prices as of the close on December 13, 2007

Company	Ticker	Primary analyst	Price currency	Price as of Dec 13, 2007	Price performance since Apr 16, 2007	3 month price performance	6 month price performance	12 month price performance
Europe Utilities Peer Group								
Biffa Plc	**BIFF.L**	**Jenny Ping**	**p**	**323.00**	**1.3%**	**41.0%**	**12.9%**	**4.9%**
Acciona SA	ANA.MC	Matija Gergolet	€	224.10	32.1%	30.9%	16.3%	60.1%
AEM SpA	AEMI.MI	Matija Gergolet	€	2.98	3.9%	16.6%	3.6%	22.4%
British Energy	BGY.L	Andrew Mead	p	529.00	-2.7%	5.7%	-1.4%	5.8%
C. Rokas S.A.	ARCr.AT	Matija Gergolet	€	19.30	-2.5%	1.6%	-3.3%	0.5%
Centrica	CNA.L	Andrew Mead	p	364.25	-8.0%	-3.6%	-0.1%	7.0%
CEZ	CEZP.PR	Matija Gergolet	Kc	1395.00	42.4%	26.6%	29.9%	41.3%
Drax Group Plc	DRX.L	Andrew Mead	p	662.00	-17.7%	7.0%	-12.3%	-19.4%
E.ON	EONG.DE	Deborah Wilkens	€	143.85	32.4%	15.2%	26.1%	41.7%
EDF	*EDF.PA*	*Andrew Mead*	€	81.79	29.5%	13.0%	18.0%	47.2%
EDF Energies Nouvelles S.A	EEN.PA	Matija Gergolet	€	48.96	10.0%	-0.6%	11.1%	27.2%
Enagas	ENAG.MC	Matija Gergolet	€	21.04	8.7%	19.5%	14.8%	2.5%
Endesa SA	ELE.MC	Matija Gergolet	€	36.73	-9.6%	-8.2%	-8.2%	2.4%
Enel SpA	ENEI.MI	Matija Gergolet	€	8.21	-0.7%	6.0%	-1.4%	4.5%
Energias de Portugal	EDP.LS	Matija Gergolet	€	4.52	9.4%	15.6%	10.8%	20.5%
Fortum	FUM1V.HE	Deborah Wilkens	€	29.68	32.1%	25.0%	29.0%	31.9%
Gas Natural	GAS.MC	Matija Gergolet	€	41.45	11.1%	12.0%	-5.7%	31.6%
Iberdrola SA	IBE.MC	Matija Gergolet	€	10.61	18.0%	11.1%	-3.4%	27.1%
International Power	IPR.L	Andrew Mead	p	450.75	8.9%	6.1%	5.2%	16.1%
Kelda	KEL.L	Jenny Ping	p	1070.00	11.0%	19.6%	10.2%	13.9%
National Grid	NG.L	Andrew Mead	p	820.50	2.6%	9.5%	13.2%	10.7%
Northumbrian Water Group	NWG.L	Jenny Ping	p	334.00	1.3%	-1.2%	7.1%	9.7%
Pennon	PNN.L	Jenny Ping	p	643.50	4.7%	6.2%	3.0%	17.8%
Public Power Corporation SA	DEHr.AT	Matija Gergolet	€	36.90	103.9%	64.3%	73.2%	88.7%
Red Electrica de Espana	REE.MC	Matija Gergolet	€	43.96	26.9%	29.8%	30.4%	23.7%
RWE	RWEG.DE	Deborah Wilkens	€	94.69	13.4%	15.7%	18.8%	6.7%
Scottish and Southern Energy	SSE.L	Andrew Mead	p	1607.00	2.0%	12.1%	10.8%	5.4%
Severn Trent	SVT.L	Jenny Ping	p	1500.00	0.9%	9.1%	1.5%	2.2%
Shanks Group	SKS.L	Jenny Ping	p	215.50	-14.4%	-4.6%	-18.7%	-10.4%
Snam Rete Gas SpA	SRG.MI	Matija Gergolet	€	4.44	-8.8%	-0.4%	1.7%	2.8%
Suez	LYOE.PA	Deborah Wilkens	€	45.21	10.0%	18.0%	13.5%	19.4%
Séché Environnement	CCHE.PA	Jenny Ping	€	120.99	-7.3%	-2.0%	-13.6%	-5.1%
Terna	TRN.MI	Matija Gergolet	€	2.73	-1.9%	6.1%	2.8%	4.3%
Union Fenosa SA	UNF.MC	Matija Gergolet	€	45.84	8.3%	19.3%	10.7%	16.3%
United Utilities	UU.L	Jenny Ping	p	756.50	-1.4%	11.1%	0.5%	-4.0%
Veolia Environnement	VIE.PA	Jenny Ping	€	61.20	7.1%	5.6%	6.4%	20.6%
Verbund	VERB.VI	Deborah Wilkens	€	49.00	41.8%	30.1%	32.0%	21.8%
FTSE World Europe				431.28	-3.2%	0.1%	-3.4%	4.3%

Note: This table shows movement in absolute share price and not total shareholder return.
Results presented should not and cannot be viewed as an indicator of future performance.

Source: FactSet, Quantum database

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Reg AC

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Growth is a composite of next year's estimate over current year's estimate, e.g. EPS, EBITDA, Revenue. **Return** is a year one prospective aggregate of various return on capital measures, e.g. CROCI, ROACE, and ROE. **Multiple** is a composite of one-year forward valuation ratios, e.g. P/E, dividend yield, EV/FCF, EV/EBITDA, EV/DACF, Price/Book. **Volatility** is measured as trailing twelve-month volatility adjusted for dividends.

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Goldman Sachs Investment Research global coverage universe

	Rating Distribution			Investment Banking Relationships		
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UniCredit
Markets & Investment Banking

Global Equity Research

Company Flash	Utilities	Germany	October 16, 2007

E.ON

Increase in electricity prices

- We have adjusted our estimates for EBIT and EPS for 2008 due to the announced increase in electricity and gas prices for household customers and the effect from the asset swap with Statkraft.
- We have increased our estimate for EBIT from EUR 9,797 mn to EUR 10,047 mn in 2008 on the group level.
- Our estimate for earnings per share rose from EUR 8.82 to EUR 9.17 in 2008.
- We calculated a target price of EUR 135.40 per share in our sum-of-the-parts valuation based on 2008 figures, versus EUR 130 before the adjustments. We included the increase in the wholesale price in our DCF model for the generation business.
- E.ON intends to swap assets with Statkraft and to take over 100% of E.ON Sverige.
- E.ON's acquisition of the majority stake in the Russian power plant company OGK-e has been completed successfully.

	2004	2005	2006	2007e	2008e
Sales (EUR mn)	49103	56399	67759	70789	74468
EBITDA (EUR mn)	10520.0	10272.0	11789.0	12121.1	13132.0
adjusted EBIT (EUR mn)	7361.0	7333.0	8356.0	9133.0	10047.0
Net income (EUR mn)	4339.5	7407.0	5556.0	6325.4	5964.5
EPS reported (EUR)	6.61	11.24	8.43	9.73	9.17
DPS (EUR)	2.35	7.00	3.35	4.50	5.00
ROCE (%)	8.8	9.0	15.4	10.4	11.2
P/E (x)	8.8	6.5	11.7	16.0	14.6
P/CF (x)	4.4	4.6	17.3	9.9	9.1
P/BV (x)	1.2	1.2	1.3	1.8	1.7
EV/EBITDA (x)	5.5	5.3	5.5	7.3	6.8
EV/EBIT (x)	7.8	7.4	7.6	9.8	8.9
ROCE/WACC (x)	1.3	1.4	2.3	1.6	1.7
Div. yield (%)	4.1	9.6	3.6	3.5	3.9

Source: Company data, UniCredit Global Research

Hold (prev. Hold)

Price on 10/15/07	**EUR 128.84**
Target price (prev. EUR 130.00)	**EUR 135.40**
Upside to TP	5.1%
Cost of equity	8.8%
High/Low (12M)	129.73/91.50

INVESTMENT HIGHLIGHTS
Increase in electricity prices
EUR 60 bn investment plan

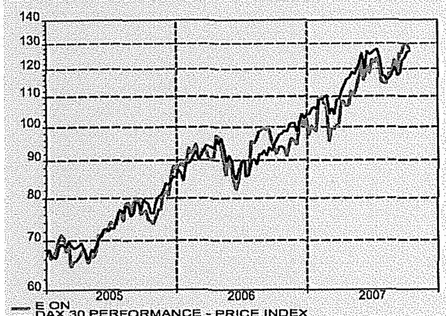
STOCK TRIGGERS
Share buyback in 2007 and 2008
Acquisition of assets from Endesa/Enel
Decision on Siberian gas field

STOCK DATA

Reuters/Bloomberg	EONG.DE/EOA GR
Average daily volume (tds.)	4411.8
Free float (%)	100.0
Market capitalization (EUR bn)	89.2
No. of shares in issue (mn)	683.2
Shareholders	Allianz 3.6%, Freestate of Bavaria 2.5%, treasury stock >5%

UPCOMING EVENTS

Annual general meeting	30-Apr-08
9M/Q3	13-Nov-07
BPC, AC	06-Mar-08



RELATIVE PERFORMANCE (% CHG.)

	1M	3M	6M
DAX	-3.9	5.2	11.9
Euro STOXX 50	-2.7	6.0	19.7
ES Utilities	-4.6	-0.7	12.1

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Target price adjusted for changes in the Electricity division

We have adjusted our estimates for EBIT and EPS for 2008 due to the announced increase in electricity and gas prices for household customers as well as the effect from the asset swap with Statkraft. We have increased our estimate for EBIT from EUR 9,797 mn to EUR 10,047 mn in 2008. Our estimate for earnings per share rose from EUR 8.82 to EUR 9.17 in 2008. We calculated a target price of EUR 135.40 per share in our sum-of-the-parts valuation based on 2008, versus EUR 130 before the adjustments. We included the increase in the wholesale price in our DCF model for the generation business.

Increase in electricity prices

Increase in electricity prices. E.ON announced electricity and gas price increases of up to 9.9% in some regions in 2008. We have included an average price increase of around 8% for 2008 in our calculations. Therefore, our estimate for the EBIT in Central Europe rises from EUR 4.9 bn to EUR 5,176 mn and from EUR 2,730 mn to EUR 2,880 mn in the Pan-European Gas division, respectively. Since the beginning of October, wholesale electricity prices left the range of EUR 54 to EUR 55 and rose above EUR 58. While we estimate the average price for the contracts in 2007 and 2008 at around EUR 51, we have adjusted the average price for 2009 onwards from EUR 54 to EUR 55. Therefore, our DCF model for E.ON showed an increase in EV. In our sum-of-the-parts valuation, all three effects add up to an increase in EV of approximately EUR 4 bn, or EUR 6.60 per share.

SOP VALUATION

		EBITDA 2008e	Multiple	EV	Remarks
Central Europe	EUR mn	6,576		47,584	DCF model
Pan-European Gas	EUR mn	3,430		24,010	DCF model
UK	EUR mn	1,880	7	13,162	
Nordic	EUR mn	1,009	7	7,064	
US-Midwest	EUR mn	587	7	4,106	
Other/Consolidation	EUR mn			11,000	
Enterprise value	**EUR mn**			**106,926**	
Net financial position	EUR mn			-1,606	
Pension provisions	EUR mn			-4,000	
Minorities	EUR mn			-6,049	
Nuclear provisions	EUR mn			-13,646	
Market value	**EUR mn**			**81,626**	
Number of shares	mn			603	
Fair value per share	**EUR**			**135.4**	

Source: UniCredit Global Research

Asset swap with Statkraft

E.ON intends to swap assets with Statkraft and to take over 100% of E.ON Sverige. E.ON and Statkraft signed a Letter of Intent on October 12, 2007, according to which E.ON will take over the 44.6% stake in E.ON Sverige that is currently held by Statkraft worth EUR 4.4 bn. In return, Statkraft will receive assets held by E.ON in Sweden, Germany, the UK and Poland as well as more than 2% of E.ON shares to compensate for the difference in value (estimated at EUR 2 bn). E.ON intends to use its own treasury shares for this purpose. The deal is to be finalized as early as in the first half of 2008. E.ON expects a one-off negative tax impact of EUR 200 mn in 2008. Group EBIT will decrease by around EUR 200 mn p.a. due to the sale of the assets, but net income will be boosted by the deal as minority interests will be reduced. By purchasing the 44.6% interest held by Statkraft, E.ON has full control of power plants with a total capacity of about 6,400 MW, 40% of which are nuclear power and around 28% hydroelectric power. The remaining 32% is oil, gas and renewable energy. In 2006, E.ON Sverige provided around 20% of power demand in Sweden.

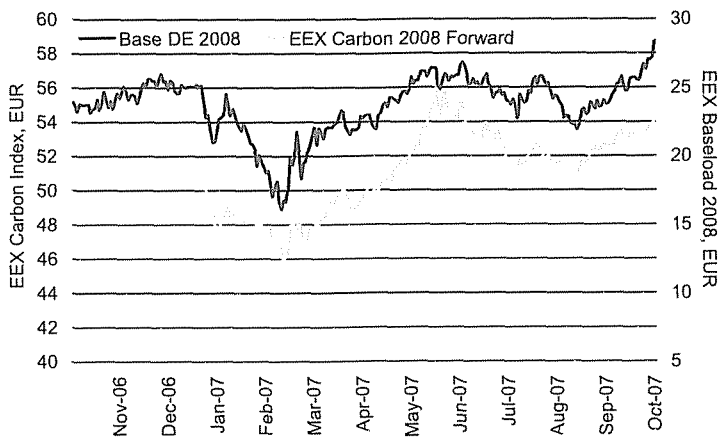
Acquisition of Russian power plant company completed

E.ON's acquisition of a majority stake in the Russian power plant company OGK-e was completed successfully yesterday. Including the capital increase, E.ON now holds 69.34% of OGK-4. The price of the acquisition amounted to EUR 4.1 bn. The acquisition of OGK-4 will be profitable only in the long term. OGK-4 only posted an EBITDA of EUR 64 mn in 2006 on revenue of EUR 766 mn, amounting to an EBITDA margin of 8.3%. By comparison, E.ON, RWE and Enel have EBITDA margins of ca. 20%. The increase in capacity – but mostly the electricity price increase and higher efficiency – should enhance profitability. E.ON plans to increase the load factor (currently 68%). The most crucial point is the increase in electricity prices, especially considering that Russia also plans to increase its gas prices to export levels as it liberalizes its gas and power markets. According to our estimates, this means that electricity and gas prices would nearly triple. OGK-4 has the possibility to switch from gas to coal for the majority of its plants, which could be important if gas prices in Russia increase sharply. E.ON expects ROCE to exceed 10% post tax after the full market liberalization and completion of the investment program in 2011 (please refer to our Company Flash published September 17, 2007).

71% of the share buyback program for 2007 concluded

Share buyback program. E.ON has bought back 20,708,800 of its shares at a value of around EUR 2.5 bn so far. This equals around 3% of share capital. E.ON intends to repurchase company shares in the amount of EUR 3.5 bn by the end of 2007 and another EUR 3.5 bn during 2008. We have calculated a reduction of 56 mn shares in our SOP valuation for 2008.

ELECTRICITY PRICES SHOW UPWARD TREND



Source: Reuters, EEX, UniCredit Global Research

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POTENTIAL CONFLICTS OF INTERESTS

Company	Key
E.ON	3, 4

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Company	Date	Rating	Currency	Target price
E.ON	07/03/2007	Hold	EUR	130.00
E.ON	06/01/2007	Hold	EUR	124.00
E.ON	04/04/2007	Buy	EUR	119.00
E.ON	03/01/2007	Buy	EUR	115.00
E.ON	02/05/2007	Hold	EUR	115.00
E.ON	12/06/2006	Sell	EUR	90.00
E.ON	09/27/2006	Underperform	EUR	90.00

Overview of our ratings

You will find the history of rating resp. recommendation changes as well as an overview of the breakdown in absolute and relative terms of our investment ratings on our websites hvbmarkets.de and http://www.mib-unicredit com/research-disclaimer under the heading "Disclaimer."

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We currently use a three-tier recommendation system for the stocks in our formal coverage: Buy, Hold, or Sell (see definitions below):

A **Buy** is applied when the expected total return over the next twelve months is higher than the stock's cost of equity
A **Hold** is applied when the expected total return over the next twelve months is lower than its cost of equity but higher than zero.
A **Sell** is applied when the stock's expected total return over the next twelve months is negative

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Restricted: A rating and/or financial forecasts and/or target price is not disclosed owing to compliance or other regulatory considerations such as blackout period or conflict of interest.
Coverage in transition: Due to changes in the research team, the disclosure of a stock's rating and/or target price and/or financial information are temporarily suspended. The stock remains in the research universe and disclosures of relevant information will be resumed in due course.
Not rated: Suspension of coverage

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Issuer level:

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Instrument level:

Core hold: We recommend to hold the respective instrument for investors who already have exposure.
Sell: We recommend to sell the respective instrument for investors who already have exposure.
Buy: We recommend to buy the respective instrument for investors who already have exposure.

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E.ON

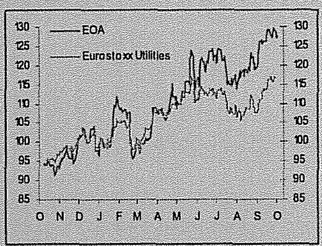
Add (=)

Germany
Utilities

Price € 131
Price target € 140 (+)

Market cap (€ bn)	85.7
N° of shares (m)	692
Daily volume (m)	3.6
Free float	95%
Reuters	EONG.DE
Bloomberg	EOA GR

Performance E.ON



TP raised upon wind value recognition

E.ON enjoys a buoyant momentum thanks to accelerated execution of the company's € 60bn investment plan. Capex progress is translating into immediate value creation on a group level as further WACC reduction to optimal levels of <9% on a pre-tax basis is no longer a foregone conclusion. On an individual basis, we didn't feel that E.ON has been overpaying for the recently announced acquisitions, even the contrary is true. Throughout this report, we'd like to demonstrate that *utilities investors should increasingly contribute value* to wind development projects beyond the value of assets in operation.

€	2005A	2006A	2007E	2008E
EPS	11.29	7.66	8.48	9.18
EPS growth	70.8%	-32.1%	10.7%	8.2%
Book Value	67.8	72.5	77.6	81.9
Dividend	7.00	3.35	4.02	4.62
Net income (m)	7,407	5,057	5,599	6,130
P/E	7.7	13.4	15.6	14.4
EV/EBITDA	7.1	7.2	8.7	8.1
FFO/Adj. Net debt	58%	47%	48%	46%
Unl. FCF Yield	4.9%	7.2%	2.8%	2.2%
Div. Yield	8.0%	3.3%	3.0%	3.5%

- **Recognition of E.ON's wind pipeline value**: The group's recent push into renewables and the upcoming IPO of Iberenova (€ 20-25bn) have inspired us to take a look at E.ON's wind development pipeline. Apart from existing assets in operation (538 MW worth € 0.9bn) and recent acquisitions in Spain, Portugal the US, Italy and France, E.ON itself has a valuable project portfolio mainly offshore oriented. It develops among the largest offshore wind parks worldwide expected to enter service around 2011. Currently, we already value the group's 4,795MW pipeline at € 1.5bn, a number which should at least double during the next three years upon completion of some projects and advanced permitting/planning.

- **We raise our TP to € 140 from € 128** reflecting the unrecognised value in E.ON's wind portfolio and improved capital structure efficiency through a number of recent value creative deals. We dare say that E.ON shares still benefit from a re-rating following its Strategy 2007-10 announcement late May and a rapid execution of its € 60bn capex program. Further upside still looks possible through the strength of the commodities market with German electricity forwards breaking the € 60/MWh level.

- **Despite 5+% upside to our new TP after the share price rally, we remain at Add** since we believe E.ON is a must to have in each (utilities) portfolio. The company has it all: most advanced gas & electricity model, well-diversified generation mix with lots of hydro & nuclear asset quality, a global wind model still being in expansion, credit strength enabling share buy-backs (currently € 7bn program) and a still inexpensive valuation.

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Equity Research
Focus

DEXIA

I. BOOST TO RENEWABLES STRATEGY

Renewables is a new cornerstone for E.ON on a global basis

How to demonstrate better the globalisation of the wind sector than referring to E.ON's two latest acquisitions in this field: i. the € 0.7bn takeover of E2 Renovables Ibericas from Dong (for more information we refer to our Focus report: "Gearing up for a green future" from August 8, 2007) and ii. Airtricity North America for which it paid US$ 1.4bn.

In this note, we focus mainly on the unrecognised value of renewable assets/projects that exist already within E.ON, namely the 538 MW in operation (€ 934m value) and 4,795 MW under development (€ 1.5bn). Renewable energies is a new cornerstone within the company's strategy with an investment budget of € 3bn allocated to this business with a plan to build an aggregate 3,200 MW of additional onshore and offshore capacity. E.ON definitely emphasises the offshore wind business which offers greater potential because it benefits from stronger, more reliable wind conditions compared with onshore wind farms. Moreover, there is greater public support for offshore facilities.

I.1. 538 MW in operation in 2006 (€ 934m asset value)

E.ON owned 538 MW wind assets in operation in 2006, of which more than half in Germany. Also in the UK and Scandinavia.

The development of renewable energies within E.ON has so far been included in the accounts of three different market units: Central Europe (mainly Germany), Powergen (UK) and Nordic. As such, development has only been pursued in those markets where it already had strong presence through existing electricity activities. We dare say that it tended to invest mainly as it was forced to comply with renewable energy standards in these regions. At the end of '06, E.ON only owned 538 MW on group level of which 295 MW of wind farms in Germany, 193 MW in the UK and 50 MW in Scandinavia (incl 20% stake in the Danish nearshore Nysted Havmollepark of 165MW). On enterprise level, we *value the existing activities in operation* at € 934m (excl. development pipeline and the two recent acquisitions)

Table 1: E.ON Renewable Energies (MW in operation) excl. latest acquisitions

Net MW	onshore	offshore	total
Germany	290	5	295
UK	192	1	193
Sweden	17	0	17
Denmark	0	33	33
Norway	0	0	0
Group	**499**	**39**	**538**

Based on our EV/MW country valuation models (€ m/ MW)

Ent. Value € m	Onshore	offshore	total
Germany	406	16	422
UK	422	4	426
Sweden	26	0	26
Denmark (*)	0	60	60
Norway	0	0	0
Group	**854**	**80**	**934**

Source(s): Dexia est.; (*) 20% of Nysted Havmollepark

I.2. and an own project pipeline of 4,795 MW (€ 1.5bn value)

Projects in development so far not valued by the market as it is mainly an unknown business

Until now we have been valuing E.ON only in function of existing (wind) assets, and as such didn't grant any value to the company's development pipeline of 5.2 GW. Although precise information on the stage of each project within the development cycle remains scarce, we have made a thorough assessment of E.ON's different projects. Tables 2-6 provide a development matrix of the company's pipeline by country and also include a country-based valuation assessment based on the following average probability ratios:

Table 2: Probability ratios

status	onshore	offshore
under construction	91%	85%
fully consented	73%	26%
planned	30%	15%
pre-planning	5%	5%

Source(s): Dexia est.

I. Germany: E.ON has a marginal presence in onshore wind development as it is rather looking to build offshore wind parks in the country, along the German coastal lines of the North and Baltic Seas. Currently, Borkum West is the most advanced project - currently under construction (60 MW in which E.ON has a 33% stake next to Vattenfall & EWE) - and it should be activated late summer 2008. Borkum West is actually a pilot project in deep water (30m) initiated by the Government. Wind turbine vendors Multibrid (recently acquired by Areva) and Repower test for the first time their 5 MW models. Borkum West will prepare E.ON for its other German offshore projects: Amrumbank West (400 MW, fully consented, online: 2011) and Arkona Becken (400 MW, fully consented, online: 2014), Sky 2000 (150 MW, in advanced permitting, online: 2010/11) and Delta Nordsee (400MW, in planning, online: 2012+).

In Germany, E.ON develops an offshore wind pipeline of 1,370 MW worth € 491m.

Table 3: Portfolio Germany

	construction	consented	planned	pre-planning	total
onshore					
offshore	20 MW	800 MW	550 MW		1,370 MW
total	20 MW	800 MW	550 MW		1,370 MW
Value € m	**€ 41m**	**€ 322m**	**€ 128m**		**€ 491m**

Source(s): own research

II. The UK: is E.ON's strongest pillar for wind development after it bought a portfolio from Renewable Energy Systems in the late nineties. E.ON is currently in construction of the 18 MW onshore wind farm Stags Holt and the 180 MW offshore wind park Robin Rigg (construction: Dec '06-'08). Robin Rigg will be the UK's largest offshore wind farm until London Array enters service in 2011. Next to Scarweather Sands (fully consented, 90 MW offshore), London Array will enter service in 2011. London Array (fully consented; 1,000 MW offshore) will even become the world's largest wind farm. E.ON owns 33% in the project (330 MW) while the remaining stakes are held by Shell and Dong. E.ON also started to plan another wind farm off the UK coast, namely Humber Gateway (300 MW).

In the UK, E.ON (through Powergen) develops a pipeline of 1,435 MW worth € 693m.

Table 4: Portfolio UK

	Construction	consented	planned	pre-planning	total
onshore	18 MW	57 MW	313 MW	144 MW	532 MW
offshore	180 MW	423 MW	300 MW		903 MW
total	198 MW	480 MW	613 MW	144 MW	1,435 MW
Value € m	**€ 417m**	**€ 166m**	**€ 110m**		**€ 693m**

Source(s): own research

In Scandinavia, E.ON develops a pipeline of 1,990 MW worth € 306m.

III. Nordic: Sweden remains E.ON's priority market in the Nordic area. Onshore, it plans 150 MW but the main focus in the country is offshore with three sizeable projects: i) 90 MW Utgrunden II which finally entered construction; ii) 50 MW Karehamn in planning phase; and iii) the 1,000 MW Southern Midsjobanken park which will be activated in the period 2012-15. E.ON (20%) and its project partners have also received permission to build Rödsand 2, a 200 MW offshore wind farm to be sited off the Danish island of Lolland. In Denmark, the company also plans another offshore wind park Nysted II which is smaller in size 40-80 MW (we took 60 MW on average). In Norway, E.ON plans various onshore wind farms of 600 MW.

Table 5: Portfolio Nordic

onshore	construction	consented	planned	pre-planning	total
Sweden			150 MW		150 MW
Denmark					
Norway			600 MW		600 MW
Nordic			750 MW		750 MW

offshore	construction	consented	Planned	pre-planning	Total
Sweden	90 MW		50 MW	1,000	1,140 MW
Denmark		40 MW	60 MW		100 MW
Norway					
Nordic	90 MW	40 MW	110 MW	1,000	1,240 MW

combined	Construction	Consented	Planned	pre-planning	Total
Sweden	90 MW		200 MW	1,000	1,290 MW
Denmark		40 MW	60 MW		100 MW
Norway			600 MW		600 MW
Nordic	90 MW	40 MW	860 MW	1,000	1,990 MW
Value € m	€ 130m	€ 6m	€ 140m	€ 30m	€ 306m

Source(s): Dexia est.

I.3. To receive green assets out of the Endesa deal € 0.6bn

Through the acquisition of Endesa/Enel assets in Italy, Spain and France (became No. 3 with Snet in which it will hold 65%) worth € 10bn, E.ON also inheritated the company's renewable energies portfolio.

France: Snet targets to have 200 MW of wind farms installed by 2010. As from March '07, Snet has one plant in operation (10 MW Léhaucourt) but it has also secured all rights and commanded orders for 10 MW in Ambon, 10 MW Muzillac and 17.5 MW Les Vents de Cernon. We estimate 48 MW to be activated before 2009 and value the unit at € 40m based on our country/probability model assuming fair EV/MW at € 1.6m/MW and fair added equity value of € 0.4m/MW (after capex deduction of € 1.2m/MW)

Table 6: Endesa renewable energies assets France

Wind park	Status	Value € m
Lehaucourt, 10 MW	In operation since March '07	€ 16m
Ambon, 10 MW	Construction ongoing - online Jan '08	€ 9m
Cernon I+II, 18 MW	Construction to start - online June '08	€ 7m
Muzillac, 10 MW	Construction to start - online Oct' 08	€ 4m
Various projects 43.5 MW	Developed by Nass & Wind	€ 4m
Total: 92 MW		**€ 40m**

Source: Snet, Dexia est

Strong asset portfolio in Italy will be heritated from Endesa. Italy ranks as one ofEurope's most attractive ***remuneration countries for wind***

Italy: Endesa Italia, which will be transferred to E.ON as well, has four own developed wind farms in operations: Florinas 20 MW (Sardinia), lardino de Durazzano 14 MW (Siciliy), Vizzini 24 MW (Sicily)and Trapani wind farm (32 MW). In compliance with the framework agreement between Gamesa and Endesa, it also purchased a development portfolio of which two wind farms already came online very recently: Montecute (42 MW) and Poggi Alti (20 MW). The three other projects that were acquired through this agreement are scheduled to come on line in Q1'08: i) Marco Aurelio Severino (44 MW), Piano di Corda (64 MW) and Serra Pelata (58 MW). In addition, Endesa Italia owns other projects of 95 MW but they are less advanced yet. Given the extremely favourable economics in Italy, we think the business is worth € 600m based on a EV/MW of € 2.5m/MW for installed capacity.

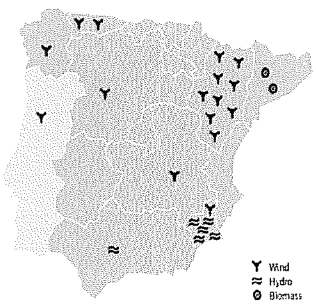
Table 7: Endesa renewable energies assets Italy

Wind park	Status	Value € m
Florinas, 20 MW	online	€ 50m
lardino de Durazzano, 14 MW	online	€ 35m
Vizzini, 24 MW	online	€ 60m
Trapani, 32 MW	online	€ 80m
Montecute, 42 MW	online	€ 105m
Poggi Alti, 20 MW	online	€ 50m
Marco Aurelio, 44 MW	construction - online Q1'08	€ 52m
Piano di Corda, 64 MW	construction - online Q1'08	€ 75m
Serra Pelata, 58 MW	construction – online Q1'08	€ 67m
Various projects, 95 MW	throughout the pipeline	€ 25m
Total: 413 MW		**€ 600m**

Source: Snet, Dexia est

I.4. The acquisition of E2 Renovables Ibericas (€ 0.9bn value)

Location of acquired assets



Since opportunities for large wind entries in Spain are dwindling, we welcomed E.ON's acquisition of E2 Renovables Ibericas, the Spanish subsidiary of Dong. A package of 260MW operational assets and 560MW development projects have been acquired for a total EV of € 722m .Available industry information reveals i. a good mix in terms of wind turbine vendors (Gamesa, MADE, GE, Siemens, Nordex, Ecotecnia, Vestas, REpower); ii. best-in-class operating hours/load factor thanks to particularly well locations: 2,450 hours in Spain (vs 2,200 hours on average in the country) and even 3,200 hours in Portugal (50% higher than in the rest of the country for reasons we are not able to identify) and iii. a slightly front-loaded portfolio as there is 90MW under construction yet out of the 560MW pipeline. E.ON has guided towards a full completion of the pipeline by 2011 with a quasi-linear roll-out (i.e. 140MW per year coming to the market). The acquired assets have generated EBITDA of ~€ 33m in 2006 on our estimates. Taking into account the new regulatory framework in Spain (a fixed € 75/MWh from 2008 updated according to CPI-0.25% until 2012), operating costs of € 25,000/MW and a linear depreciation schedule, we expect EBITDA to rise progressively to € 138m upon completion of all projects. Our DCF-based model fairly values the underlying MW for these operational assets at € 1.9m/MW or 12x EBITDA. This translates into a fair EV of some € 500m for the 260MW. For the assets under development, we take the fair EV (€ 1.9m/MW) and deduct the necessary capex (€ 1.2m/MW) from it to arrive at a fair equity value of € 0.7/MW in the case of 100% probability. We decided not to apply our in-house probability matrix since E.ON indicated the pipeline assets of 560MW are already probability weighted and thus reflect the necessary uncertainty/failure discount. We therefore see the equity value of the pipeline at almost € 400m. We feel quite assured on this figure by the fact that 90MW is yet in the stage of construction (80+% probability). All in all, the price of €722m is relatively attractive when compared to our valuation of almost € 900m. For more details on this acquisition, we refer to our focus report on E.ON: *Gearing up for a green future* dating from August 8, 2007.

I.5. The acquisition of Airtricity North America (€ 1.9bn value)

The growth potential of the US market is big

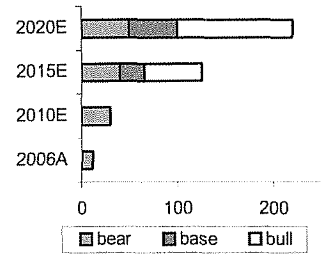
While the US market was the largest in adding new wind capacity in 2006 (+ 2.5GW), it still only operates 11.6GW of wind farms producing 25TWh or 0.6% of total US generation. The current US electricity mix consists of coal (50%), natural gas (19%), nuclear (19%) and hydro (7%) with the rest generated by oil. The State unofficially requires 21GW of non-hydro renewables by 2010, but industry associations put forward a target of at least 30GW by then, making the US an untapped investment dream for wind farm developers and operators especially when understanding the fundamentals of the market: i. a huge electricity market of 4,250 TWh per year (almost 10x Spain), ii. excellent wind resources with annual operating hours at 3,050 versus 2,200-2,300 for Spain; and iii. supportive remuneration schemes. In 2007, we expect another record year of new installations (4GW). Looking further into 2015-20, we could expect the US government to set a nationwide target of 10% to come from renewables, of which 60-70% from wind. This would mean the wind industry will need to grow to more than 100GW (x8 compared to today) creating future value even for unidentified sites. Those developers with a good position already today will be able to capture most of this value in our view. If the RPS system (see below) won't be accepted nationwide, there is still an obligation of having min. 50 GW by 2020 only looking at those States to which the RPS currently applies. The US wind industry could eventually even beat everyone's most optimistic expectations as, referring to a study made by the American Wind Energy Association, potentially 10,777 TWh could be produced from available wind resources which is 2.5x the total electricity generated in the US and 43x the actual production by wind farms. Graph 20 shows the upper limit of wind electricity installations that are feasible and affordable. Hugest potential lies in North Dakota, Texas, Kansas, South Dakota and Montana while in practice the installed MW have mainly been built in Texas, pulling ahead of Californa (even in in top 15 of States' with highest technical potential).

Graph 1: Max. potential TWh from wind

1	North Dakota	1,210	11	Colorado	481
2	Texas	1,190	12	New Mexico	435
3	Kansas	1,070	13	Idaho	73
4	South Dakota	1,030	14	Michigan	65
5	Montana	1,020	15	New York	62
6	Nebraska	868	16	Illinois	61
7	Wyoming	747	17	California	59
8	Oklahoma	725	18	Wisconsin	58
9	Minnesota	657	19	Maine	56
10	Iowa	551	20	Missouri	52

Source: American Wind Energy Association

Graph 2: US wind estimates GW



Source: Dexia est.

This upper limit of 10,777 TWh would necessitate 3,600 GW of installed wind capacity which requires additional investment of € 4,000 bn (!). Such investment figures seem too far away from reality, but they show that lifting the 'not yet existing' nationwide RE target to 20% (blue sky) is no doubt witin technical and economic reach. Currently, the US Department of Energy and the American Wind Energy Association are evaluating the objective of having 20% following a statement by President Bush on the topic of renewable energies. Under the assumption that onshore wind energy takes up 60-70% within the renewables package of 20%, 220 GW of wind installations could be on the market by 2020.

Favourable regulatory framework on State Level

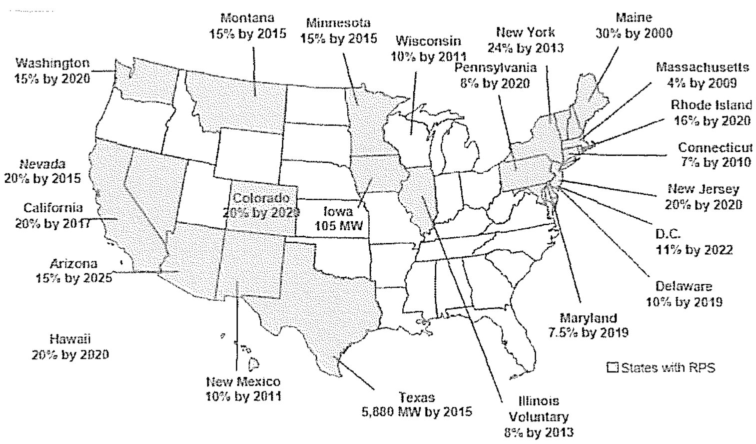
US State governments are finally seriously encouraging renewable energy through two energy policies: i. renewable portfolio standards (RPS) and ii. production tax credits (PTC). On the federal level, there is not yet one clear policy though but there is a high level engagement of an increasing number of States to assure market growth, especially when the extension of the PTC system beyond 2008 is voted by the US Congress.

Window stability from the PTC that provides a US$ 19/MWh tax credit to wind farm operators over the first ten years.

→ The **PTC system** grants wind farms a credit of US$19/MWh (pre-tax value US$26/MWh) during their first 10 years of operation. They are indexed to inflation and locked-in at plant completion. As a result, wind farms are much more competitive than other conventional power plants. The credit helps to level the playing field for wind in the energy sector, which is one of the most heavily subsidized in the US economy. There are no limits to the availability of PTCs, which makes momentum very strong. In addition, the US scheme is structured to reduce investors tax helped by an accelerated depreciation over five years and so to provide maximum cash flows. It is true however that only big utilities that pay federal taxes (thus not municipal utilities) can use the tax credits to reduce their tax liability. Local or municipal utilities however can receive the benefits as well when assuming equity positions in wind plants.

→ The **RPS policy** requires minimum levels of production coming from renewable energies within a certain State (e.g. 15% in Arizona and 20% in California). The system also provides green credits (worth US$ 12.5/MWh) during the 25 years lifetime of the project. While the US federal government has failed to endorse strong renewable energy policies, a growing number of states have enacted policies of their own. At present, not more than 21 States have RPS in place with an average objective to reach 10% of electricity production from wind. It is highly likely that more States will adopt the RPS policy but it is too early to believe it will be valid for all States shortly.

Graph 3: States with RPS



Source(s): GWEC

Valuation of a generic wind park in the US: EV/MW @ € 1.75m

Valuation of US wind farm in line with Spain despite many structural differences.

We value a MW wind in the US at € 1.75m, only a fraction below the value of a Spanish wind farm. Still there are many structural differences between the parameters used for both countries: i. operating hours in the US at 3,050 (+35-40% vs Spain); ii. feed-in tariffs for Spain versus a regime of 10-year tax credits and variable green credits make us apply an unlevered beta of 0.50x for Spain versus 0.76x for the US iii. lower WACC for Spain (6.5%) versus 8.6% for the US reflecting the aforementioned beta profile but also the higher cost of debt in the US and typically lower debt structured financing.

Table 8: DCF input/output

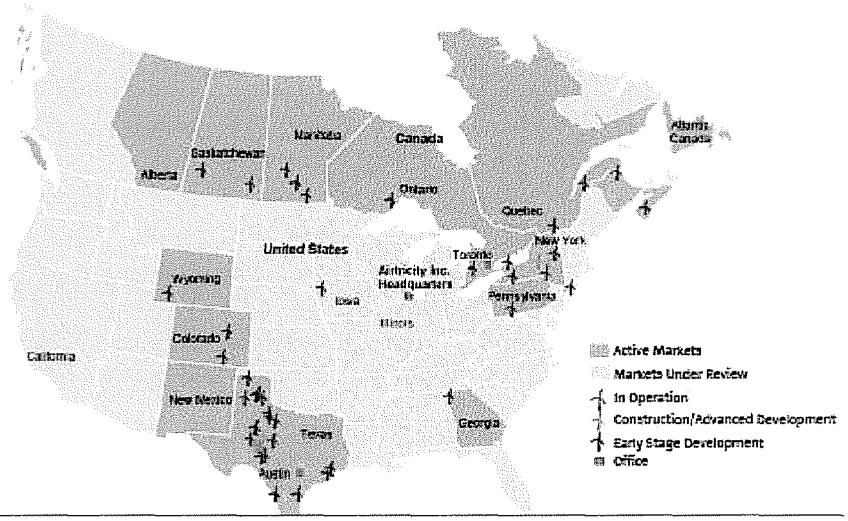
Electricity price PPA (US$/MWh)	55.6	Capex €/kW	1,200
RPS green credit (US$/MWh)	12.5	Debt portion	55%
PTC pre-tax (US$/MWh)	26.0	WACC %	8.60%
Full price (US$/MWh)	94.1	Ent Value €/kW	1,750
Operating hours	3,050	Added Eq. value €/kW	550

Source(s): Dexia est.

Details about E.ON's transaction

E.ON acquired Airtricity NA for US$1.4bn incl US$ 0.6bn debt. The company expects the deal to be closed by year-end 2007. The portfolio includes highly attractive assets in the US wind market with 214 MW in operation yet, an advanced development portfolio of 2,000 MW in Texas and New York ans further early stage projects of 5,000 GW all over US and Canada as shown on the map below.

Graph 4: Map of portfolio assets Airtricity North America



Source(s): E.ON

We apply our country valuation (as explained in table 8) for the different projects according to their stage of development. We arrive at a total value of € 1.9bn (US$ 2,700m) almost double the price E.ON bought the assets. In terms of capex, E.ON expects to spend US$ 3.5bn to develop the assets under or close to construction (2,000MW) which equals € 1.2m/MW, more or less in line with the country assumptions we made. Note that the company already secured turbines for approx. 1,300MW of the development pipeline. We forecast Airtricity North America to generate € 400m EBITDA by 2011 (vs € 40m in 2007E) once those additional 2GW capacity has entered service.

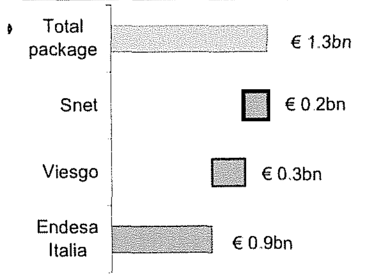
Table 9: Portfolio North America

Status	MW	Probability used	Value € m
Operational	214 MW	100%	€ 375m
Under construction	877 MW	91%	€ 900m
Advanced projects (permits)	1,000 MW	73%	€ 400m
Early stage projects	5,000 MW	10%	€ 275m
Total (all onshore)	~ 7,100 MW		**€ 1,900m**
			US$ 2,700m

Source(s): own research

I.6. Putting the green pieces together

EBITDA from Enel/Endesa deal



We value E.ON's renewables business actually at € 5.8bn but this valuation already reflects the inclusion of the Enel/Endesa assets in France & Italy. This transaction is expected to be closed in H1'08 (valuation process to be announced rather soon in our view). So far, we have no idea yet what the precise acquisition value will be although E.ON itself has committed € 10bn for the full package of assets. Given the fact that the underlying known assets in this Endesa/Enel deal already generate recurring EBITDA of € 1.3bn and that fair multiples for conventional electricity assets in Spain, France and Italy point to minimum 8.5x EBITDA, we can hardly believe that E.ON paid any value for the pipeline (i.e. non-operational assets) of the renewable projects held in France and Italy. We believe the package price comprises a € 1bn value creation (being (€ 1.3bn x 8.5) minus the price to be paid € 10bn) excluding a free lunch of some € 250m on the wind projects pipeline.

Table 10: Overview financials of E.ON Renewables

Status	MW '06 online	MW '11E online	EBITDA '11 est.	Value € m
E.ON Energie	295 MW	865 MW	€ 240m	€ 913m
E.ON UK	193 MW	871 MW	€ 320m	€ 1,119m
E.ON Nordic	50 MW	180 MW	€ 65m	€ 329m
Endesa Italia		318 MW	€ 80m	€ 600m
Endesa France		48 MW	€ 8m	€ 40m
E2 Ren. Ibericas		820 MW	€ 138m	€ 900m
Airtricity NA		2,000 MW	€ 400m	€ 1,900m
E.ON Group	**538 MW**	**5,102 MW**	**€ 1,251m**	**€ 5,801m**

Source(s): own research

When putting all pieces together, we think that E.ON will have 5,102 MW of wind assets online by 2011 compared to 538 MW at present (excl acquisitions). Those assets will generate EBITDA of € 1.3bn which is equal to 10.5% our EBITDA '07 forecast. It clearly demonstrates E.ON's commitment to focus on green/clean energies. Remind that E.ON's € 60bn investment plan 2007-10 foresaw € 3bn for the renewables division. At present however, E.ON already spent € 1.7bn on two acquisitions to which we have to add development capex of € 4.8bn (€ 1.3bn for Spain and € 3.5bn for the US & Canada). In addition, we also believe € 2.5bn of capex is needed to construct the wind projects currently in late development stage. As a result, the business would require € 7.3bn in total capex incl acquisition price.

Table 11: Investments E.ON Renewables 2007-10

Investment	EV paid € m	Incl development capex € m
E2 Renovables Ibericas	€ 0.7bn	€ 1.3bn
Airtricity North America	€ 1.0bn	€ 3.5bn
German projects held		€ 0.8bn
UK projects held		€ 1.2bn
Nordic projects held		€ 0.2bn
Italian projects (package)	To be finalised	€ 0.2bn
French projects (package)	To be finalised	€ 0.1bn
Total E.ON Renewables	**€ 1.7bn excl Italy, France**	**€ 7.3bn**

Source(s): own research

UPDATED SOTP: € 140/SHARE

Table 12: Sum-of-the-parts E.ON

Market unit	€ m	EBITDA '08x		Comment
i. Central Europe	48,845	8.4		DCF
ii. Pan-European Gas	21,711	8.4		DCF
iii. UK	18,156	9.4		DCF
iv. Nordic	11,719	8.2		DCF
v. US Midwest	4,112	7.0		DCF
vi. E2 Renovables Ibericas	900	14.2		
vi. Corporate center	-4,500			
= Core business	**100,043**	**7.6**		
- Net debt	863			year-end 2007E
- Acquisition price Skarv Idun	638			
- Minorities (post Statkraft buy-out)	4,550			market value est.
- Pension provisions	2,850			year-end 2007E
- Nuclear provisions	14,192			year-end 2007E
- Other LT provisions	6,861			year-end 2007E
- Net deferred tax liability	5,940			
+ Financial assets	27,391			
o/w through equity method	12,894			12.5x net profit '07E
o/w share investments	12,102			incl Gazprom
o/w financial receivables	2,395			
= Fair equity value	**91,539**	**€/share**	**135**	
+ value creation Enel/Endesa assets	1,250			
+ value creation Airtricity NA	900			
+ *value creation* E.ON *Nordic buy-out*	900			
= Target price	**94,589**	**€/share**	**140**	

Source(s): Dexia est

We have updated our valuation on E.ON from € 128 to € 140 per share. This upgrade has been triggered by three main elements:

- Acquisition spree and share buy-backs € 7bn to optimise capital structure: Recent spendings (Norway upstream gas: US$ 892.5m; OGK4 Russia electricity € 4.1bn; Airtricity North America € 1.0bn; E2 Renovables Ibericas € 0.7bn; buy-out E.ON Nordic minorities € 4.4bn) were necessary in our view to cover the gaps in E.ON's portfolio but actually they have accelerated the erosion of the debt-free balance sheet and turn it more likely E.ON will succeed in executing its € 60bn investment plan. This will warrant an optimal structure with a debt factor (= economic debt/ adjusted EBITDA) of around 3.0x. We have incorporated the lower WACC impact throughout the valuation of the different market units.

- The acquisitions also turn to be value creative on individual basis since acquisition prices appeared rather modest compared to the fundamental valuation we calculate. In this context, we mainly refer to the package to be transferred from Enel/Endesa to E.ON (€ 11bn value versus € 10bn to be paid), to E2 Renovables Ibericas (€ 0.9bn value versus € 0.7bn paid), to Airtricity North America (€ 1.9bn value versus € 1.0bn paid) and to the buy-out of minorities in E.ON Nordic (€ 0.9bn value creation in our view although we miss precise details).

- Unrecognised value in wind development: On top of the € 0.9bn asset value from wind farms in operation across Germany, the UK and the Nordic area, we now have started to include the value from projects under development as well. As demonstrated in paragraph I.2, the company's existing (thus not recently acquired) pipeline of almost 5GW is worth € 1.5bn which we allocate to the three market units in particular.

COVERAGE BY PRIMARY ANALYST

Steven De Proost: Utilities
Companies covered: Cegedel, Distrigas, Electricité de France, Elia, E.ON, Fluxys, Gaz de France, Iberdrola, MVV Energie, RWE, Suez, Poweo, Union Fenosa

ANALYST CERTIFICATION

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We use four stock recommendations which refl ect the share's expected absolute performance as follows:

Buy: we expect this stock to generate a return of >15% over the next twelve months
Add: we expect this stock to generate a return of 5-15% over the next twelve months
Neutral: we expect this stock to generate a return of 0-5% over the next twelve months
Reduce: we expect this stock to generate a negative return over the next twelve months

DISTRIBUTION OF RATINGS/INVESTMENT BANKING RELATIONSHIPS

As of September 30, 2007, the Dexia Bank Belgium equity research has active investment recommendations on [62] securities. We disclose the percentage of rated securities to which we assign a Buy, Add, Neutral and Reduce rating on a quarterly basis. We also include the recommendation composition on securities for which Dexia Bank Belgium has undertaken investment banking actions over the last twelve months.

Rating category	Buy	Add	Neutral	Reduce
Rating distribution	29.0%	30.6%	27.4%	12.9%
Investment banking relationship	36.0%	18.0%	46.0%	0%

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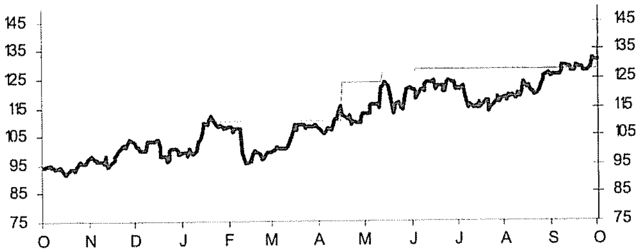
12-MONTH PRICE TARGET CHART



Date	Target price
19-Oct-2007	140
21-June-2007	128
31 May 2007	127
4 May 2007	124
24 August 2006	115
22 February 2006	110
25 November 2005	96
5 July 2005	90
19 May 2005	83

HISTORY OF RECOMMENDATIONS

E.ON stock has been covered by Steven De Proost as from May 19, 2005.

Date	Recommendation
08 Aug 2007	Add
01 June 2007	Neutral
4 May 2007	Buy
4 April 2007	Neutral
5 February 2007	Add
23 May 2006	Buy
4 January 2006	Add
19 May 2005	Buy

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DEXIA

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SOCIETE GENERALE
Cross Asset Research

Germany
12-month target upgrade

23 October 2007

Equity Research

Electric Utilities

E.ON

Benchmark status restored

Buy (12m)

Price 19/10/07	12m target
€131.3	€150.0

Sector Weighting
Overweight

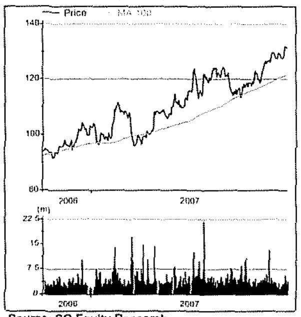
Preferred stock
EDF

Least preferred stock
Fluxys

Type of investment

Share buyback	✓
Undervalued	✓
Growth	✓

1 year



Source: SG Equity Research

Risk

Stock vs sector
Sector vs market

E.ON
on www.sgresearch.socgen.com

- **Investment case** We remain at Buy and raise our 12-month target price from €135 to €150, implying 14% upside. Management has staged a strong comeback after months spent in the unsuccessful pursuit of Endesa. We forecast that the targeted 10% annual average EBIT growth will be comfortably achieved, and that the group's EBIT profile, currently over-reliant on mature markets, will become more exposed to growth segments (over 21% by 2010e compared with 7% in 2007e). We have revised up our medium-term wholesale power forecasts, from €55/MWh to €62/MWh, and we note that the formerly poisonous political and regulatory environment in Germany has improved to an appreciable extent. Our EPS forecasts are raised by 5.3% for 2008e and 11.6% for 2009e. The share price is on a 20% P/E discount to the sector on 2009e, a widening yield premium, and a 13% discount to our sum-of-the-parts analysis (sector average discount, 7%). As E.ON's new strategy bears fruit, such cheap ratings will become increasingly difficult to justify.
- **Catalysts for the share price** Over the coming months, we expect the rise in oil, gas, coal, and CO2 prices to be followed by rises in forward power prices, which in our view must more fully reflect the CO2 price as investment on new power capacity accelerates – this should boost the sector as a whole. In the first half of 2008, E.ON is due to announce the acquisition of €10bn of assets from Endesa and Enel, giving it a foothold on faster-developing southern European markets and boosting its growth profile.
- **12-month target price and methodology** Our target is raised from €135 to €150, based on sum-of-the-parts (SOTP), discounted cash flow (DCF) (6.6% WACC, 1% growth rate to perpetuity) and peer group comparison. Our anticipation of higher energy prices has led us to raise the value and earnings forecasts of E.ON's generation and gas businesses.
- **Alternative scenarios and risk to our scenario** Despite high energy prices, wholesale power fails to rise – we believe this is unlikely since it would penalise returns on new investments. The German government once again looks for ways to re-regulate tariffs. The regulator cuts distribution grid tariffs strongly in late-2007.

Share data			
RIC EONG.DE, **Bloom** EOA GR			
52-week range			132.0-91.7
EV 07 (€m)			109,151
Market cap. (€m)			90,825
Free float (%)			95.3
Performance (%)	**1m**	**3m**	**12m**
Ordinary shares	3.8	7.9	39.6
Rel. Eurofirst 300	2.8	11.7	28.6

Financial data	12/06	12/07e	12/08e	12/09e
Revenues (€bn)	64.09	69.11	81.23	85.05
EBIT margin (%)	13.0	13.0	12.9	13.3
Rep. net inc. (€bn)	5.31	5.39	6.13	6.84
EPS (adj.) (€)	7.10	7.89	9.29	10.66
Dividend/share (€)	3.35	4.10	5.00	6.00
Payout (%)	88.6	41.0	42.8	45.2
Interest cover (x)	12.5	15.8	7.6	7.8
Net debt/equity (%)	nm	16.8	52.2	49.7
Prev. EPS change (22/10/07)		7.73	8.79	9.84

Ratios	12/06	12/07e	12/08e	12/09e
P/E (x)	18.5	16.6	14.1	12.3
FCF yield (/EV) (%)	17.2	3.2	2.1	2.1
Dividend yield (%)	2.6	3.1	3.8	4.6
Price/book value (x)	1.9	1.8	1.8	1.6
EV/revenues (x)	1.68	1.58	1.51	1.46
EV/EBIT (x)	12.9	12.1	11.7	10.9
EV/IC (x)	1.7	1.6	1.5	1.4
ROIC/WACC (x)	1.3	1.5	1.5	1.5
CAGR 06-09e: +14.5%				

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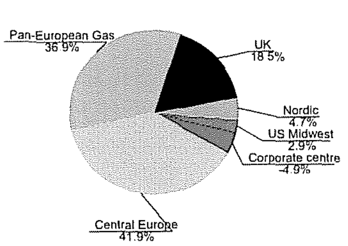
Societe Generale and affiliates beneficially own 1% or more of any class of common equity of E.ON

Group anatomy – business overview

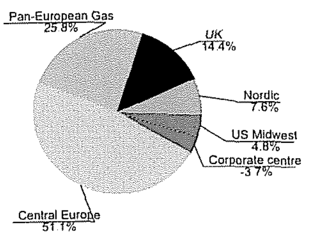
E.ON is Europe's second largest utility after EDF. It has strong positions in Germany, the UK, the Nordic region, central Europe, and the US MidWest. Following its failure to secure Endesa, E.ON is deploying its financial strength to expand in higher growth markets, such as renewables, Russia, Spain, Italy and eastern Europe.

Sales/division 2007



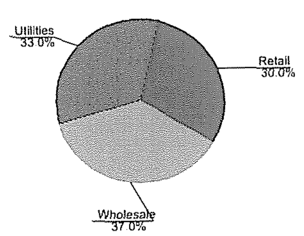
E.ON splits its divisions into five geographic areas. The most important are central Europe, dominated by Germany, and Pan-European gas (Ruhrgas, acquired in 2003)

EBIT/division 2007



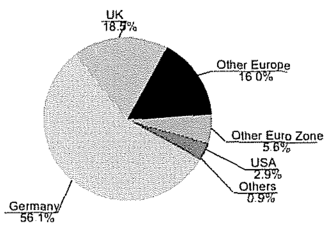
Power price rises should drive the earnings of central Europe, while Pan-European gas is dictated by the weather and oil prices. New divisions, such as renewables and Russia, could be included in 2008

End-market exposure 2007



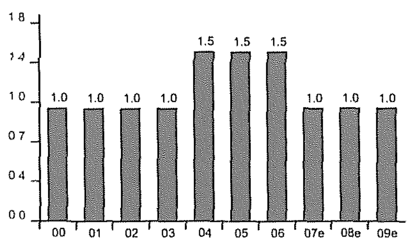
E.ON has an ideal balance between direct wholesale customers, other utilities, and retail. This makes it more defensive than RWE, which in the near term benefits from higher wholesale exposure

Sales/region 2007



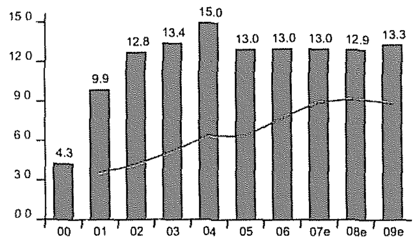
Over half of E.ON's sales in 2007 will be in Germany, followed by the UK, Sweden, the Czech Rep, Hungary, and the Netherlands.

Revenues organic growth (%)



Demand growth will be slow in Germany and the UK, where E.ON's market share may decline slightly

EBIT margin (red) and ROIC (grey) (%)



New investments in Russia and renewables offset margin growth in Germany in 2008, but over time a gradual decline in Germany will be balanced by higher returns in renewables, etc

Competitive landscape

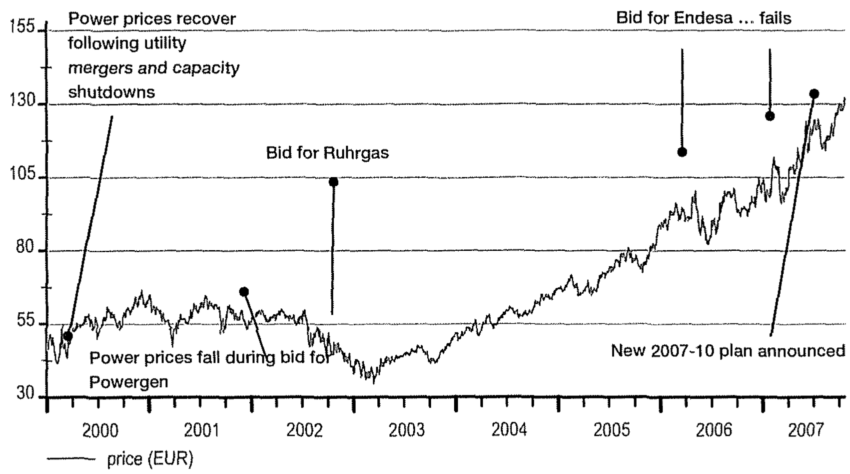
Business	Company market share	Sales CAGR (5y)	Company EBIT margin	Avg sector EBIT margin	Main players
Central Europe	20%	4%	14.7%	13.3%	EDF, RWE, Enel
PanEuropean Gas	50% in Germany	3%	8.4%	9.2%	GDF, Eni, Centrica
UK	11% gen, 15% supply	2%	9.8%	11.0%	Centrica, npower
Nordic	11%	4%	19.3%	21.0%	Vattenfall, Fortum

Source: SG Equity Research

Group anatomy – performance and valuation

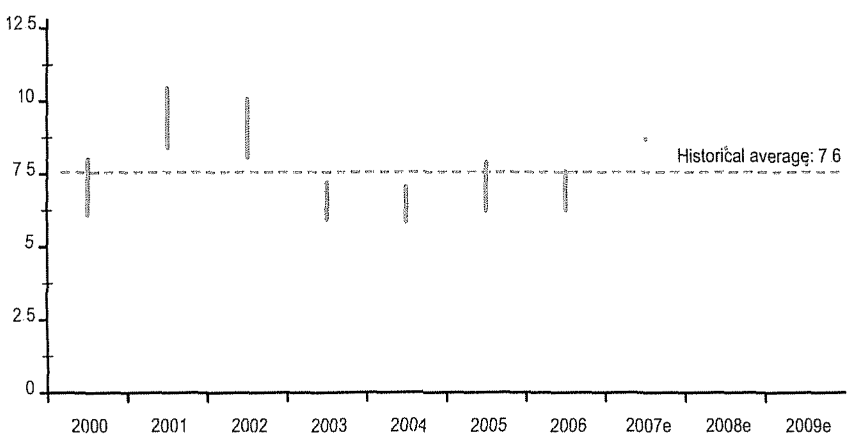
The rise in energy prices has been the principal reason for four years of strong performance. The advent of the CO2 trading mechanism has been an added positive

E.ON. Historical share price performance



Rating has traditionally been at a discount to the market due to over-reliance on Germany, *strategic question marks*, and insufficient presence on growth markets

E.ON. Historical EV/EBITDA ratio (%)



SG EPS revision vs IBES

	Cur.	07e	08e	09e
SG EPS (adj.)	€	7.89	9.29	10.66
IBES EPS	€	7.85	8.82	9.55
SG vs IBES (%)		0.4%	5.1%	11.6%
SG EPS change at 22/11/07 (%)		+0.1%	+5.3%	+11.6%

Source: SG Equity Research

Contents

Investment summary

Power price forecasts raised

We have raised our German forward base load power price estimates, from €55/MWh to €62/MWh, following SG's recent increase in forecasts for commodities and CO2. We expect a fuller pass-through of CO2 than currently appears to be the case as the investment cycle accelerates, and we expect E.ON, benefiting from its balanced existing portfolio and its early-mover advantage in new generation expenditure, to benefit.

Matrix of E.ON electricity price calculation for industrial customers

	2005	2006	2007e	2008e	2009e	2010e
Av achieved price (€/MWh)	32.6	38.3	47.5	53.7	57.5	60.9
Prev estimate (€/MWh)				53.5	55.0	55.0
Change – yoy	*+14.4%*	*+17.4%*	*+24.0%*	*+13.1%*	*+7.1%*	*+5.9%*
% upgrade				*+0.4%*	*+4.5%*	*+10.7%*

Source: SG Equity Research

An improved operating environment at home

We have also witnessed gradual improvement in the previously very difficult environment in German electricity, characterised by attacks from the government, the regulator, the EU, and the cartel office. The German government has stepped back from re-regulation of prices, sharply harsher treatment of polluting generation plant post-2012 is largely anticipated, the RWE-cartel office compromise on past pricing fails to bring into doubt the legitimacy of the market-based mechanism and represents a reversal for the cartel office, and the utilities have felt confident enough to signal price rises for retail customers in 2008.

Factors currently influencing the German power and gas sector

	Scope	Subject	Potential impact on E.ON
1	EU	Ongoing proposal for ownership unbundling of transmission, appointment of EU-wide regulator	Would provide valuation of grid assets, benefiting share; E.ON may sell regardless of EU decision
2	Germany	No cancellation of nuclear phase-out after 32y operating life	No decision + no E.ON closures scheduled before next election
3	Germany/EU	Future CO2 costs/allocations post 2012	E.ON estimates adequate returns on new investment with CO2 a €40/t, implies electricity >€65/MWh
4a	Germany	Network regulation fees for 2008	Hit of c€100m
4b	Germany	Network incentive regulation from 2009	Announced cost reductions to offset impact
5	Germany	Cartel Office case against RWE	Compromise of limited power auctions could extend to E.ON, negligible potential impact
6	Germany	Burden of proof to switch to utilities in cases on pricing	Minor at worst. E.ON never lost a significant case in the past
7	EU	Investigation on alleged E.ON-GDF pact connected to MEGAL pipeline	Negligible

Source: SG Equity Research

Quick delivery on 2007-10 plan improves E.ON's growth profile

Better growth profile, a balance sheet that is balanced, effort to simplify

E.ON's management has made a remarkable comeback after the failed 2007 bid for Endesa, announcing what appeared at the time (end-May) as an ambitious 2007-10 investment plan but following it up with a raft of decisions and asset-reshuffling that we believe puts the group in a strong position to deliver on its stated targets of: i) 10% average annual rises in EBIT to

2010; and ii) the elimination of an over-capitalised balance sheet through a doubling in debt-plus-provisions as a percentage of EBITDA, between 2006 and the end of 2008.
Although not always without risk, we believe that E.ON's rating will benefit from announced moves in renewables (€4bn), Russian generation (€5bn), and Spain/Italy (€10bn), which we estimate will triple the proportion of E.ON's EBIT in what could be categorised as 'growth segments', from 7% in 2007 to over 20% in 2011e, with more to come from medium-sized (but not blockbuster) acquisitions to arise over time.

We also like management's commitment to proactive portfolio measures such as the swapping of Statkraft's large minority position in E.ON Sverige with various E.ON generation assets plus a 2% stake in E.ON taken from treasury stock. This allows greater scope for full integration of E.ON's Nordic activities and (in contrast to recent measures by other utilities) sharply cuts the presence in its accounts of minority interests, whose existence is frequently viewed as a reason to provide a stock with a discount rating. We believe that there is a growing likelihood that part of the Gazprom shareholding could be divested or swapped.

Upgrade of estimates, ahead of consensus...

We have raised our forecasts by 5% in 2008 and 12% in 2009, on the basis of investments already announced, our new energy forecasts, and our expectation that E.ON can easily beat its 2007-10 cost improvement target, mainly from distribution and trading, of €1bn.

SG estimates higher than consensus

	SG	IBES	SG as % of IBES
EBIT (€m)			
2007e	8,994 (flat)	8,802	+2.2%
2008e	10,501 (+3.2% on prev est)	9,807	+7.1%
2009e	11,322 (+5.5% on prev est)	10,514	+7.7%
EPS (€)			
2007e	7.89	7.88	+0.1%
2008e	9.29 (+5.4% on pre vest)	8.82	+5.3%
2009e	10.66 (+11.6% on pre vest)	9.55	+11.6%

Source: SG Equity Research

...brings discount rating that will be increasingly difficult to justify – Buy maintained, TP raised to €150

With 13% average annual 2007-11e EPS growth, the steady but not reckless gearing-up of a previously over-capitalised balance sheet, and deployment of capital in growth markets, the E.ON share becomes increasingly cheap as time goes on. The stock trades at a 13% discount to our estimated sum-of-the-parts (SOTP) valuation (sector average, 7% discount to SOTP), and is attractive on P/E multiple and yield basis.

E.ON's discount too wide

Closing prices 22 October 2007	P/E 2008e (x)	P/E 2009e (x)	EV/EBITDA 2008e (x)	EV/EBITDA 2009e (x)
E.ON (€131.3)	14.1	12.3	8.3	7.8
RWE (€92.5)	13.5	11.8	6.9	6.4
Germany	13.9	12.2	7.8	7.3
Sector	17.0	15.4	8.8	8.2
E.ON discount rel to sector	17.1%	20.1%	5.7%	5.0%

Source: SG Equity Research

E.ON's yield increasingly attractive

Prices as of 22 October 2007	2006	2007e	2008e	2009e	2010e
E.ON ord dividend (€)	3.35	4.10	5.00	6.00	7.00
RWE ord dividend (€)	3.50	4.20	4.00	4.50	5.00
E.ON yield (€131.3)	2.6	3.1	3.8	4.6	5.3
RWE yield (€92.5)	3.8	4.5	4.3	4.9	5.4
Sector yield		3.4	3.6	3.9	4.3
E.ON yield premium		-8.9%	5.5%	17.9%	23.3%

Source: SG Equity Research

We believe that as E.ON's 2007 investments translate into earnings, the discount rating must erode, particularly as Russian and renewables profits start to kick in at our €150 target price.

As a result of our higher forecasts, our DCF value of E.ON rises by 11% to €151. Our SOTP, boosted chiefly by higher valuations of E.ON's generation assets, also rises by 11%, to €150. With rising energy prices and a proactive management, the stock should continue to outperform. We retain our Buy recommendation, increasing our 12-month target price from €135 to €150. At such a level, and based on our 2010 forecast, the stock would trade at 12.6x earnings and a 4.7% yield.

Short term, RWE (upgraded to Buy, TP €105) could outperform E.ON

E.ON offers stronger medium-term value than RWE, benefiting from a more balanced business structure, a surer industrial and financial strategy, plus less exposure to lignite and to the danger of pre-election nuclear closures. In the near-term, however, it is RWE – which has underperformed E.ON by 16% over a year – that could well outperform, due precisely to its imbalanced structure (over-dependent on Germany and on lignite, long on generation and wholesale power customers) that will allow it to benefit more fully from higher German power prices.

RWE is also at a discount of around 10% to E.ON on P/E and EV/EBITDA on our new estimates, which we have upgraded more (EPS 2009 raised by 18.0% for RWE, by 11.6% for E.ON). One can argue that this is justified, but RWE benefits additionally from the apparent market approval (which we share) of the perception that its new CEO will adopt a more expansive strategy.

What are the risks to our €150 TP and Buy recommendation?

Downside risks to our 12-month price target and buy recommendation include the following:

- We could be too optimistic on our power price forecasts, which are based on higher oil, coal and CO2 estimates. Lower power prices would weigh on sector performance, in particular those long on generation such as RWE, Fortum, EDF, and Verbund.

- We (and the market) expect that the German utilities will have to purchase at least 80% of their CO2 requirement from 2013. If harsher targets are set then this could weigh.

- We could be wrong in that E.ON could bid for assets (such as the 40% of ACS in Union Fenosa) at a price that appears too generous – this would damage the reputation, won back by management, of safeguarding its own shareholders interests rather than those of its targets.

Clouds lifting in domestic power

Summary – shorter-term gain for RWE, medium-term comfort for E.ON

We have become more positive on the outlook for E.ON's Central Europe division, which we estimate will account for 48.1% of consolidated 2008 EBIT. For 2008, we assume full-year inclusion of OGK-4, the full 100% of E.ON Sverige, Airtricity's north American wind farms, and the assets to be acquired from Enel and Endesa. There are two reasons for our increased optimism:

- The pricing environment.
- The political environment.

Both of the two major German utilities benefit from this improving environment. In the shorter term, it is the less defensive and less integrated RWE that stands to gain the most, since:

- Its high exposure to Germany, its generation-heavy structure (RWE Power buys in only 31% of its electricity needs versus 53% for E.ON in central Europe) and its greater direct exposure to wholesale customers are more beneficial.
- The competitive position of lignite has improved during NAP II for as long as rises in gas and hard coal prices outweigh those of CO2, lignite being extracted from open-cast mines that are owned by the utility and situated adjacent to power generation plants – thus, lignite is not open to price volatility and is not affected by transport costs.
- Further out, however, we believe that E.ON enjoys several advantages over RWE, which afford it better visibility in the current political and regulatory environment:
- E.ON's earnings are more balanced and less exposed to Germany.

Market exposure of leading European utilities – RWE looks over-dependent on Germany

	Comment	% of 2008e EBITDA in home markets
RWE	Assumes American Water deconsolidated	76
GDF Suez	Takes France + Benelux as home market, assumes E&P as overseas profit	70
EDF	-	66
Fortum	-	66
E.ON	Assumes acquisition of €10.5bn of overseas assets from Enel/Endesa	58
Enel	Assumes pro rata consolidation of 67% of Endesa	56
Iberdrola	Includes SPW, Energy East	50

Source: SG Equity Research

1) E.ON has little exposure to lignite, RWE's speciality, in which it appears that preferential treatment after 2012 will no longer be received.

2) Although E.ON has greater relative exposure to nuclear (half of continental European output versus a quarter for RWE), it is only RWE that is scheduled for significant closures (Biblis) before the 2009 legislative elections.

3) On a more general view, there is greater strategic and financial certainty at E.ON. E.ON has already committed to investments that will gear up its balance sheet to an acceptable extent, whereas RWE, under a new CEO, is under pressure to follow suit.

Pricing – upgrade of our forecasts

Medium-term German base load forward: €62/MWh from €55/MWh

We have revised up our medium-range forecasts for base load forward electricity prices in Germany from €55/MWh to €62/MWh. This is based on changes in our September 2007 SG Commodities Review *Breaking the tackle*. Our forward price forecasts consider above all the marginal cost of production, rather than the average cost taken into account for the spot price forecasts found in the Commodities Review. As is known, the majority of RWE and E.ON volumes are sold on the basis of forward contracts.

SG forecasts used for calculation of medium-range base load German forward electricity

	End 2008	Medium-range
ICE Brent $/b	67.3	60
Coal API 2 (CIF Rotterdam) $/t	77.8	58
Zeebrugge Natural Gas £p/th	39.1	42
Carbon EUA Phase II €/t CO2	26.9	30
$/€	1.45	1.40

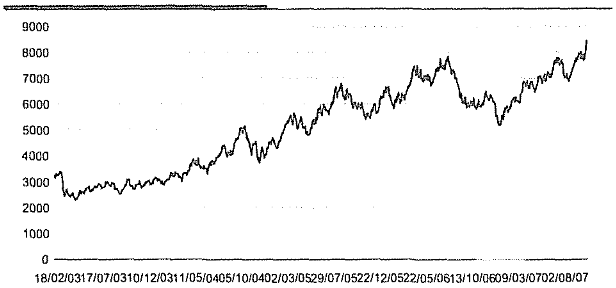
Source: SG Equity Research

Upgrade follows higher energy forecasts and new-build component costs

Our upgrades are based on several factors:

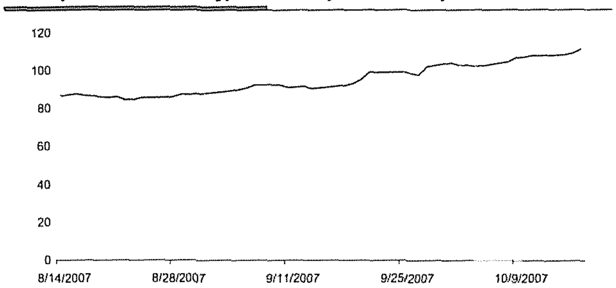
- The increase in our energy and carbon price forecasts, only partially offset by our expectations that the US dollar will remain weak at 1.4/euro.
- The acceleration of capital expenditure on new plant in Germany, and the need to reflect all of CO2 within the forward price in order for new entrants to be enticed in – ultimately, the big four utilities may well want this to happen, so as to avoid being obliged to finance the entire 40GW+ of new capacity required by 2020.
- The scarcity of components (steam turbines, steam generators, etc) and higher metals prices (for high-pressure pipes) have brought double-digit increases in new-build costs – further increases are seen as inevitable, to the extent that RWE and E.ON have preferred to commit now to new-build, despite there being no post-NAP2 framework in place nor a final decision regarding the nuclear phase-out, in order to avoid losing their advanced position in the lengthy queue for components.
- We also believe that there has been a recent trend in industrial customers, fearing a price rise, to lock in their electricity supply into 2009 and beyond.

Brent in $/b



Source: SG Equity Research, Reuters

Coal (October maturity) CIF ARA (Amsterdam) $/t



Source: SG Equity Research, Reuters

Below, we set out our calculations for *wholesale base load electricity prices*.

Calculating the wholesale price from coal

	Calculation	Result
Coal price (SG estimates)	$65	$65/t
Divided by thermal energy in 1t of coal	/ 7.1MWhth	
Assuming 35% efficiency of the *marginal* coal-fired plant used to satisfy final unit of demand	x 35%	
Gives coal cost in $/MWh		$28.1/MWh
Adjusted for exchange rate	€1/$1.4	
Gives coal cost in €/MWh		€20.1/MWh
Add CO2 cost at 0.9t of CO2 per MWh, CO2 at €30/t	€27.0	
Gives total coal and CO2 cost in €/MWh		€47.1/MWh
Add dark spread	€16/MWh	
Wholesale electricity price		€63.1/MWh

Source: SG Equity Research

Calculating the wholesale price from oil

	Calculation	Result
Brent price (SG estimates)		$60/b
Converted into $/Mbtu	/6	
Converted into $/therm	/10	
Converted into p/therm	$2.0/£	42.5p/therm
Converted into kwh at 29.3kwh/term	/29.3	1.45p/kwh
Assuming 50% efficiency of CCGT	x2	
Gives gas cost of CCGT (x1,000 to convert to MWh cost) in £	X1,000	£29.0/MWh
Gas cost of CCGT in €	X1.45	€42.1/MWh
Add CO2 cost at 0.37t of CO2 per MWh, CO2 at €30/t	€11/MWh	
Add clean spark spread	€12/MWh	
Wholesale electricity price		€65.1/MWh

Source: SG Equity Research

A quarter of E.ON's power procurement is from non-emitting, stable-cost sources...

Of E.ON's central Europe 2006 power procurements of 281TWh, 25.4% came the group's self-generated nuclear and hydro facilities (stable, non-CO2 emitting) and 3.1% from self-generated lignite (CO2 emitting but stable-cost apart from that).

...while RWE benefits from its longer position in generation...

RWE (2006 power procurements of 270TWh in continental Europe) appears to benefit more in the near term, but the future impact is clouded by the impending closure of its Biblis nuclear reactors and by the post-NAP II prospects for lignite as the heaviest-polluting generation source.

E.ON and RWE positive impact from higher wholesale prices

	E.ON	RWE
Self-generated nuclear, hydro – stable cost, benefit from higher wholesale	25.4%	19.2%
Self-generated lignite – stable cost excl CO2, partial benefit from higher wholesale during NAP II (reduces as CO2 rises)	3.1%	27.0%
Other self-generated – gas, coal, no significant benefit from higher wholesale	18.0%	23.2%
Purchased electricity – no benefit	53.3%	30.6%

Source: RWE and E.ON annual reports, SG Equity Research

...and its greater weight of direct wholesale customers

Below, we set out our forecasts for E.ON's average achieved wholesale price in its Central Europe division. E.ON sells around 100TWh annually direct to wholesale customers or to the open wholesale market, versus around 160TWh for RWE.

Given that E.ON, as well as RWE and others, sells its electricity on average 18 months forward, we see more impact on our numbers from 2010 from upcoming price increases, as illustrated in the table below. Our estimates are for average wholesale prices for E.ON of €53.7/MWh (up 13.1%) in 2008, €57.5/MWh (up 7.1%) in 2009, and €60.9/MWh (up 5.9%) in 2010.

Matrix of E.ON electricity price calculation for industrial customers

		2004		2005		2006		2007e		2008e		2009e		2010e
Time contract agreed	*% output*	Av price (€/MWh)	*% output*	Av price (€/MWh)	*% output*	Av price (€/MWh)	*% output*	Av price (€/MWh)	*% output*	Av price (€/MWh)	*% output*	Av price (€/MWh)	*% output*	Av price (€/MWh)
2002 FY	*40%*		*5%*	26.0										
2003 H1	*35%*		*20%*	28.5										
2003 H2	*15%*		*25%*	33.0	*10%*	33.0								
2004 H1			*35%*	34.2	*20%*	34.2								
2004 H2			*15%*	36.6	*25%*	36.6	*15%*	35.8						
2005 H1					*35%*	42.0	*20%*	42.0						
2005 H2					*10%*	45.0	*20%*	45.0	*15%*	45.0				
2006 H1							*20%*	54.0	*20%*	54.0				
2006 H2							*25%*	55.0	*25%*	55.0	*15%*	55.0		
2007 H1									*20%*	55.0	*20%*	55.0		
2007 H2									*20%*	57.0	*25%*	57.0	*15%*	57.0
2008 H1											*20%*	60.0	*20%*	60.0
2008 H2											*20%*	62.0	*25%*	62.0
2009 H1													*20%*	62.0
2009 H2													*20%*	62.0
Av achieved price	*100%*	28.5	*100%*	32.6	*100%*	38.3	*100%*	47.5	*100%*	53.7	*100%*	57.5	*100%*	60.9
Prev estimate										53.5		55.0		55.0
Change – yoy				+14.4%		+17.4%		+24.0%		+13.1%		+7.1%		+5.9%
% upgrade										+0.4%		+4.5%		+10.7%

Source: SG Equity Research, SG Commodity Research estimates

As a result of our new pricing forecasts, we have slightly increased 2008-09 estimates for E.ON's Central Europe division (around plus 2%). Perhaps more importantly, the outlook for 2010 and 2011 looks significantly more positive.

Political and regulatory – not ideal, but less harsh

While the environment in German electricity remains difficult, the clouds appear to have lifted to some degree over recent months in that:

- Economics minister Glos has dropped his earlier ambitions to push through a new cartel law that would effectively allow electricity prices to be linked to different modes of generation (tantamount to re-regulation).
- For the new tariff-capped regulatory mechanism for transmission and distribution to start in 2009, regulatory periods will be longer and assumed productivity improvements less challenging than previously expected.

Below, we set out the political, regulatory and environmental issues influencing the German power sector. We argue that, faced with a tight reserve margin and a consequent need to accelerate investment on new generation, the utilities find themselves in a stronger position than the government, and there are limits on what can be done on behalf of the consumer at a time when E.ON, RWE, EnBW and Vattenfall Europe are looking increasingly at realising an adequate return on upcoming investments.

Factors currently influencing the German power and gas sector

	Scope	Subject	Status	Potential outcome	Potential impact on E.ON
1	EU	Ongoing proposal for ownership unbundling of transmission, appointment of EU-wide regulator	Resisted by France, Germany, and others	French + German integrated utilities to sell part/all of transmission grids?	Would provide valuation of grid assets; E.ON may sell E.ON Netz regardless of EU decision. But E.ON gas business model would be damaged if Ruhrgas has to sell grid
2	Germany	No cancellation of nuclear phase-out after 32y operating life	Fundamental disagreement between coalition partners	No decision before 2009 election, when need CDU/CSU majority for nuclear extension	No E.ON closures scheduled before election, but RWE could lose one or even two reactors
3	Germany/EU	Future CO2 costs/allocations post 2012	German Govt likely to continue to target utilities	Utilities to buy substantial majority of CO2 allocations after 2012	E.ON estimates adequate returns on new investment with CO2 a €40/t, implies electricity >€65/MWh
4a	Germany	Network regulation fees for 2008	Applications for rises have been sent to BNetzA, utilities expect cuts	Cuts of 3-5% vs 2007	Hit of c€100m
4b	Germany	Network incentive regulation from 2009	Welcomed by major utilities, ending cost-plus mechanism	BNetzA has announced 1.25% average annual assumed productivity gains 2009-13	Announced cost reductions to offset impact
5	Germany	Cartel Office case against RWE	Compromise reached, which could be seen as a defeat for cartel office	Clients could sue, cases would drag for years	Compromise of limited power auctions could extend to E.ON, negligible potential impact
6	Germany	Burden of proof to switch to utilities in cases on pricing	Autumn decision	More risk from pre-emptive measures, but ultimately proof of profiteering needed	Minor at worst .. E.ON never lost a significant case in past
7	EU	Investigation on alleged E.ON-GDF pact connected to MEGAL pipeline	End-July EC announced inquiry re alleged agreement to keep out of each other's main market	2008 decision? GDF has been winning new clients in Germany	Negligible

Source: SG Equity Research

1. EU proposal for grid ownership unbundling – strong political opposition is welcome for E.ON

As many countries opposing as in favour

The European Union, through Energy Commissioner Piebalgs, is strongly committed to forcing through a proposal to separate transmission grid ownership from generation/production and supply. However, it is meeting with strong opposition not only from Germany and France, but also from many of the recently-joining countries nervous of the potential for Gazprom to increase its influence. Any final decision appears to be some way off.

Member countries for and against unbundling

Against unbundling	Population	Energy cons. per capita MVTU p.a. per capita	For unbundling	Population	Energy cons. per capita MVTU p.a. per capita
Germany	82.5	173	Belgium	10.5	260
Austria	8.2	179	Denmark	5.4	165
Bulgaria	7.7	113	Spain	43.5	150
Cyprus	1.0	141	Finland	5.2	234
France	60.7	187	Netherlands	16.3	249
Greece	11.1	130	Romania	21.6	76
Latvia	2.3	68	UK	60.1	166
Luxembourg	0.5	397	Sweden	9.0	234
Slovakia	5.4	149			
	179.4	171		171.6	170

Source: SG Equity Research / Le Monde (review) – country's average energy consumption per capita

Electricity – insignificant impact either way

Insufficient information to value electricity grid E.ON Netz with confidence

As is known, major utilities are fully integrated into transmission in Germany, France, Scotland, Austria, and the majority of the recent EU joiners. Only in Germany is there no national grid company. The German utilities do not provide any separate accounts for their transmission businesses (contrary to EDF in France, where the grid company RTE appears as a separate entity) and E.ON provides no earnings numbers for its regulated activities, although it intends to start reporting from 2008. In Germany alone of the major western European countries, we have no RAB supplied by the regulator. In our E.ON model, we have valued E.ON Netz at a 10% per-km discount to our estimated 2008 RAB, to be decided by the CRE regulator in France for RTE (currently 100%-owned by EDF). As with RTE in our EDF model, we consider it justified to attach a 10% RAB premium, given the potential for divestment of a stake and that recent M&A has given 25% average premiums to RAB. This implies an EV of €2.19bn for E.ON Netz.

E.ON Netz, we value at a 10% discount to RTE

Grid company	Km of high voltage grid	Valuation (€m)	Valuation per km (€)	10% acquisition premium (€m)
RTE	99,100	11,621	117.3	12,783
E.ON Netz	18,820	1,986	105.5	2,185

Source: SG Equity Research

E.ON could sell E.ON Netz regardless of EU decision on unbundling

We attach a premium since E.ON has stated that it may divest its transmission business regardless of what the EU decides (to unbundle, or not to unbundle). The fact that E.ON has chosen to cast doubt on the future retention of E.ON Netz within the group would suggest that returns (we estimate 7-8% ROCE) are not particularly attractive in transmission by comparison with potential profitability in new generation.

E.ON is determined to deliver not only on increasing its 'debt factor' (debt plus provisions as a multiple of EBITDA from 1.4x in 2006 to 3x in 2008), which suggests that it needs to sell nothing. However, we see E.ON Netz as a realistic target for disposal since:

- E.ON has pledged to "take concrete portfolio measures' for all assets not providing 'financial/strategic value'.
- In view of the €17bn of acquisitions announced since March 2007 (Endesa/Enel assets, wind assets of Dong in Spain and Airtricity in the US, OGK-4) plus ongoing buybacks as well as probable future moves in renewables, upstream gas, and eastern Europe, there could be financial grounds for divestments.

In our view, the revealing of the value of E.ON Netz, either through unbundling or through disposal, would be a mild positive for the stock.

Gas – unbundling Ruhrgas grid would be damaging to E.ON

E.ON appears to have satisfied the German regulator BNetzA that its high pressure gas network does not constitute a monopoly business and should therefore be exempt from regulation, on the grounds that E.ON Ruhrgas frequently operates in competition with the Wintershall-Gazprom joint venture Wingas, which operates parallel pipelines (although one could debate the intensity of competition, given that through Ruhrgas E.ON is Gazprom's largest foreign shareholder with 6.4%).

However, this does not exempt E.ON from the EU's push for ownership unbundling. The fact that half of Europe is against unbundling is therefore welcome for E.ON. We believe that for E.ON, the retention by Ruhrgas of its grid is essential, since without it, the fundamental business model of the company is threatened. We can expect the company to make a considerable amount of noise if unbundling threatens to become a reality, citing the risks of security of supply.

2. Nuclear phase-out to be maintained at least until 2009 – E.ON more protected in near term

Government's aims to phase out nuclear and cut CO2 emissions are unrealistic without price hikes

The continued existence of the German policy to shut down existing nuclear reactors after an average operating life of 32 years could give rise to a considerable headache in future. While other countries are rethinking the merits of nuclear in a CO2-cutting, high energy price environment, the German SPD states that a rethink of the early phase-out is not negotiable, leaving Chancellor Merkel to make periodic (and ignored) statements in favour of an extension of the lives of the existing reactors. The Environment minister's view is that Germany can reach its target of cutting 2020 emissions by 36% from 1990 levels (previous target for a 20% cut), even with a nuclear phase-out, through building more wind farms (does there remain a hill in northern Germany without a wind farm?) and accelerating development of coal-fired plants with full carbon capture (efficiency of such plants estimated by RWE to lag that of new conventional coal by 5-14%).

SPD needs to be out of Government for nuclear reprieve

Few expect any debate on dropping the nuclear phase-out law within the current coalition. However, nuclear will undoubtedly become a major topic in the 2009 legislative elections – indeed, it is already a major topic, with Environment Minister Gabriel differentiating himself by stressing his distaste for nuclear and the CDU increasingly stressing their favour for life extensions. Nuclear extension looks likely to depend upon an absence of either the SPD or (probably) the Greens from the post-2009 ruling administration.

Blackout risk avoided during Biblis closures thanks to mild weather...

To an extent the German coalition has been lucky this year, since the lengthy unscheduled closure of the Biblis reactors coincided with a mild winter, cool summer (with above-average wind), and improved hydro availability. If the Biblis closures had coincided with 2006 weather, then Germany could have experienced periods of acute tightness between demand and available supply.

...but Germany not out of woods yet, and public opinion may turn

For what it is worth, we believe that, at some point and possibly because of a blackout, the German public will become aware that both CO2 emissions and electricity prices must rise if the phase-out is in place, and that the phase-out will be scrapped. But this may well be too late for RWE's Biblis reactors.

E.ON to avoid closures if compromise by 2010

E.ON 'enjoys' a safer position than RWE because, despite having a higher proportion of its generation from nuclear, it is RWE that could be the one to suffer through the final closure of its Biblis reactors before the next election – the government has refused to transfer four years of output from Mulheim Karlich reactor (closed in 1988 before it came onstream) to Biblis A, and the fact that both Biblis reactors have had one year of unscheduled outage may well not delay the final closure beyond the election. Of the 'big four' utilities, E.ON should suffer the least in that only 3% of its nuclear capacity, owned through its 33% interest in Brunsbuttel, are likely to be lost assuming no decision before the next election, compared to over a quarter for RWE and over 20% for EnBW. Thus, if the impact of nuclear phase-out is to boost average electricity prices, then E.ON (whose production profile will be virtually unchanged), will be the beneficiary.

E.ON output the last to suffer through current nuclear phase-out plans

Reactor	Owner(s)	Capacity MW	Year of start of commercial operation	Scheduled year of closure under existing phase-out programme
Biblis A	RWE	1,020	1974	2008-09
Neckarwestheim 1	EnBW	840	1976	2009
Biblis B	RWE	1,300	1974	2008-09
Brunsbuettel	Vattenfall 67%, E.ON 33%	806	1976	2008-09
Isar	E.ON 100%	1,200	1979	2010

Source: SG Equity Research

Upside of €9 per share if 50 years' average output from E.ON reactors

At present, our valuation of E.ON's nuclear reactors is the equivalent of €1.15m EV/MW, two-thirds the level we ascribe to EDF. A nuclear reprieve in Germany, with an assumption of 50 years' average output, would bring our valuation of E.ON's reactors to a similar level to those of EDF, implying a boost of €9.3 per share.

3. Despite harsher carbon purchase requirements, E.ON and RWE appear happy to invest

German reserve margins (and those of its neighbours) are low, and look set to remain thin.

Estimated reserve margins in Europe, 2005

2005	UCTE average	UK	F	B	GR	I	D	E	NL
Current reserve margin	4.8%	2%	2%	3%	4%	5%	6%	6%	9%

Source: CapGemini European Energy Markets Observatory, October 2006

The numbers below, which appear to show slight improvement on those in the table above, fail to reflect the unscheduled closure of the Biblis reactors.

German reserve capacity

Date	Reserve capacity vs peak demand in GW
July 2007	9
July 2008	10
July 2010	9
July 2015	7
July 2020	2

Source: UCTE, RWE

Why are German reserve margins so tight? A lesson from the past

It is worth asking ourselves why Germany suffers such tight reserve margins, when it can be recalled that there was a situation of overcapacity as recently as 1999. In the immediate aftermath of liberalisation in April 1998, the following happened in relatively quick succession:

- Wholesale and industrial prices fell sharply, by an average of 27% by the end of 1999, with some prices down as much as 60%. EnBW and RWE were particularly aggressive in pursuing volume ahead of margin. Many contracts were negotiated at breakeven or even loss.
- In 1999, just one month apart, two mergers were announced – Veba/Viag to form E.ON and RWE/VEW – in addition, various smaller mergers took place including that of HEW, Bewag, Veag and Laubag under the ownership of Vattenfall.
- In 2000, and within a period of less than three months, capacity closures (or mothballing) of over 10GW were announced by the dominant four utilities RWE, E.ON, EnBW and Vattenfall.
- Helped by the refusal of the large utilities to accept contracts below marginal cost, as well as by rising fuel costs, electricity wholesale prices recovered.

New entrants have failed to penetrate...

In our view, by accident or by design, the process described above represents a faultless series of steps enacted by the big utilities, toward ensuring benefit from the arrival of liberalisation – boosting profitability through concentration while indicating to any potential would-be entrant what could happen if it attempted to make inroads. We have seen no significant new entrant arrival since liberalisation, for various reasons including:

- The large utilities have the advantages of scale and the existence of fully amortised plant acting as cash-cows and absorbing the cost of new investments.
- There is no guarantee that what happened to prices in the immediate aftermath of the 1998 liberalisation may not to some extent recur.

- It is not entirely obvious that in Germany the opportunity cost of CO_2 is at present being fully passed on.
- It is notoriously difficult in Germany to persuade customers to switch supplier.

We may see instances of smaller local utilities being invited to partner the large players (such as MVV as E.ON's partner in Kiel), but even here, rising costs have frequently put them off, leaving the large utility to go it alone.

...and need even higher prices (high €60s/MWh) to succeed

The conclusion of this is that the main utilities are overwhelmingly in control of the German market. For new entrants to penetrate, which the 'big four' may in fact now want (in order to avoid taking the full financial responsibility for all the new generation investments required, as discussed below), prices will have to rise perhaps even further than our forecast of €62/MWh, to over €65/MWh, especially given that from 2013 onwards the generators will doubtless have to buy the large majority of their CO_2 certificates.

Germany needs massive investment, with or without early nuclear phase-out

As RWE has pointed out, Germany's conventional power generation fleet is ageing, and over one-third of conventional capacity is scheduled to shut down by 2020 even with a nuclear extension (over 40% assuming that the current early nuclear phase-out law is implemented).

German electricity installed capacity breakdown

	Capacity GW	% of total	Marginal cost of production €/MWh incl CO2
Must-run: run-of-river, CHP, renewables	19	16	2-10; subsidised
Nuclear	24	20	20-25
Lignite	23	19	35-40
Hard coal	36	30	40-50
CCGT, OCGT	13	11	45-52
Peaking (oil, OCGT, hydro, etc)	5	4	>50
Total	120	100	

Source: VDEW, RWE, SG Equity Research

Upcoming electricity generation closures in Germany – by 2015 and by 2020

GW	Closures by 2015e	Closures by 2015 if no early nuclear phase-out	Closures by 2020e	Closures by 2020 if no early nuclear phase-out
Nuclear	8	3	20	10
Coal	9	9	12	12
Gas, oil, lignite, other	3	3	13	13
Total	20	15	45	35

Source: RWE

Despite lack of post-2012 framework, multiple new projects have been announced

German NAP2 implies that the utilities would have to purchase some 40% of their carbon allocation in 2008-12. Beyond, we should assume that a substantial majority of allocations must be bought, although there is unlikely to be any definitive decision until 2011 at the earliest. Meanwhile, the utilities have to decide on investment on generation projects to last until at least 2050. Despite what appears a less than clear framework, numerous generation projects have been announced, as illustrated below. But the BNetzA regulator estimates that no more than 30% of such projects will see the light of day.

Planned power projects in Germany

Year	Hard coal MW	CCGT/Gas MW	Lignite MW	Total MW
2007		2,125		2,125
2008e		2,420		2,420
2009e		850		850
2010e	700	2,600	2,100	5,400
2011e	6,070	530	675	7,875
2012e	10,260			10,260
2013-14e	3,200/3,650		0/450	3,650
After 2014e	2,965	3,620	660	7,245
Total	58-59%	30%	9-10%	39,825
Of which certain				9,000
Of which certain/likely (BNetzA estimate)				12,000

Source: VDEW, RWE

E.ON and RWE enjoy advantages from their mass, their early moves on new build, and their cushion of fully-amortised plant

How certain are these projects to see the light of day? If they involve new entrants investing either on their own or in partnership with other new entrants, then there is little certainty of completion. We can assume that the new builds announced by E.ON (see below) and RWE go through, largely because they can benefit from synergies through operating 'convoys' of plants and because they know that if they delay projects now they are likely to face lengthy delays as well as price rises in eventually procuring components for the new units (discussed earlier). New entrants in Germany (even if large companies) will, we estimate, suffer at least 5% higher new-build costs than E.ON and RWE because of their lack of existing critical mass and higher turbine prices (we roughly estimate up 50% or more in three years to up to €200/kW for a standard new CCGT), before we even start to consider the absence of fully amortised nuclear on which to fall back.

E.ON new generation projects, Germany

Location	Energy source	Capacity MW	Estimated start of operation	Comment
Irsching 5	CCGT	820	2009	New, 58% efficiency, partnership with N-Ergie, Mainova
Datteln 4	Hard coal	1,050	2011	Replacing old plants
Irsching 4	Gas turbine	530	2011	New, 60% efficiency
Staudinger 6	Hard coal	1,100	2012	Replacing old plants
Kiel	Hard coal	800	2014	Unconfirmed, partnership with StW Kiel

Source: E.ON, SG Equity Research

Coal is more volatile in price than lignite, but lignite's dirty status to cut its competitive advantage after 2012...

Both E.ON and RWE have indicated that their investments should yield an adequate return (minimum of 9% in our view) even with full purchase of all carbon allocations at a price of €35-40/t. Since it seems that lignite-fired plants are to receive few or no advantages, then coal (€0.9 rise per €1/t rise in CO2) and CCGT (€0.4 rise) will inevitably improve their competitive position relative to lignite (€1.1 rise) and could threaten to jeopardise lignite's traditional position as a base-load generation source in the German merit order. The fact that lignite is locally mined on the site of the electricity generation plant, offering stability in cost (excluding CO2) and providing jobs, does not as yet seem to be sufficient to safeguard its position.

...which remains a major medium-term worry for RWE

E.ON's exposure to lignite is minor compared to that of RWE, and it is this factor that represents the principal cloud on RWE's far horizon.

Exposure to lignite

	% 2006 own output through lignite-fired generation
Germany	24
E.ON	6
RWE	37

Source: SG Equity Research

The major factor to remember, however, is that both E.ON and RWE, presiding over a satisfactorily tight market, enjoy advantages over the competition and are likely to benefit from firm prices over a long period of time.

4. Network regulation – modest cost-cut assumptions should be beaten by E.ON

We estimate that 9% of E.ON's gross SOTP valuation, or €15 per share, comes from its domestic electricity grid business, of which 20% is in transmission, which the European commission may force E.ON (and others) to partially or completely divest.

E.ON provided against a regulatory impact from the start of 2006

It is worth recalling that E.ON provided €325m in 2006 toward the impact of anticipated grid fee cuts retroactive to the start of 2006, whereas the cuts took place around September. RWE chose not to adopt such a conservative approach. A final decision on whether tariffs should have been cut to the start of 2006 is yet to be made, and will be settled in Court over the next six months. It could be that other distributors will eventually have to pay for grid fee cuts in the past, a scenario that would be met with opposition from the municipal grid owners. More likely, in our view, is that the date of the cuts will stand, implying that E.ON could well be in a position to write back the €325m of provisions set aside in 2006.

Cuts for 2008 and tariff-capping from 2009

We expect the BNetzA to announce average 3-4% average grid fee cuts for 2008, in order to achieve what it sees as a reasonable level in time for the start of incentive regulation in January 2009. The way that the new tariffs are presented may cloud the actual extent of the cuts, since they are likely to be announced in comparison with the fees requested by the various distributors. Since the distributors are likely to have applied for significant rises (in the hope that they may at least get something), the announcements may be of double-digit reductions, compared with our estimate of a reality of 3-4% cuts.

From 2009, the current cost-plus methodology will be replaced by a tariff-capping system, implying that, for the first time, cost-cutting will be incentivised.

E.ON stepping up cost-cutting measures in regulated distribution...

In May 2007, E.ON announced €600m efficiency gain measures to 2010, but none of this is included in regulated activities since E.ON is considering that any cost-cuts will be clawed back by the regulator. Member of the E.ON board Christoph Daenzer-Vanotti is quoted in the German press as considering 1,500 job cuts in regional distribution (we estimate 6-7% of the total) and complaining that the grid business is "on the borderline of profitability". E.ON could also be considering a rise in the working week from 36 to 38 hours with no accompanying wage increase. The company's relationship with its unions has been generally favourable in recent years.

...which should outweigh regulator's targets

E.ON has been more circumspect than RWE in predicting the trend in profits from its regulated activities, as one would expect given that E.ON gives no earnings numbers in the first place (although this should change from 2008). It does, however, indicate that margins are unexciting after recent tariff cuts. Nonetheless, the utilities should be happy both at the (modest) annual average productivity gains assumed by the BNetzA as well as the five-year regulatory period.

Change to tariff-capping should be positive

As far as E.ON and RWE are concerned, they benefit from the existence of hundreds of municipal-owned distributors that we believe to be less efficient, essential for municipal budgets, ponderous in decision-making. We have conservatively assumed that E.ON will be categorised by the regulator as a distributor of average efficiency, and as a result will be given a target of annual productivity improvements of 1.25%. We also assume that E.ON will beat this with 1.5% annual cost improvements.

The upcoming regulatory periods and efficiency targets

Regulatory period	Annual productivity gains assumed
1: 2009-13	1.25%
2: 2004-18	1.5%

Source: SG Equity Research

RWE Energy, which operates the RWE group's distribution, transmission and supply activities, sees a rebound in 2008 earnings to 2006 levels, after a 5-10% fall in 2007, and stable earnings in 2009 – we predict 4% annual increases from 2008. E.ON should be able to achieve at least such a performance, with retail margins rising to partially offset the squeeze in distribution.

5. Knock-on impact on E.ON from FCO case against RWE? Negligible threat

Despite protesting its innocence, RWE agreed to power auctions to ward off threat of court action

The German Federal Cartel Office (FCO) recently dropped its case against RWE in which it alleged that RWE charged overly-high prices in 2005 due to inclusion of the price of CO_2 in its wholesale tariffs (that year, it received 96.5% of its emissions certificates free of charge). While maintaining that there was nothing wrong in including CO_2 in its wholesale tariffs, RWE decided that, rather than face the prospect of multiple court cases, it was preferable to agree to auction 1,600MW of fully amortised lignite or hard coal capacity (equating to output of 11.5TWh) to its industrial customers each year from 2009 to 2012. This is the equivalent of just 4% of the group's continental European volumes, implying a very minor impact.

E.ON worst-case impact would be insignificant

As yet, we have seen no move from the FCO to establish a case against E.ON. If the FCO does decide to move, we are uncertain if E.ON, which typically adopts a more robust stance than RWE, would agree to auction more capacity in order to head off the risk of court action. If

E.ON made similar concessions to RWE, the impact would be negligible, remembering E.ON's lesser dependence on Germany and on wholesale industrial customers.

6. FCO to switch burden of proof from customer to utility supplier

While Economics Minister Glos has not followed through initial efforts to base prices on the cost of different generation sources (i.e. regulate prices), what remains on the cards is the delegation of greater powers to the cartel office. This implies:

- More aggressive checks that the utilities are not artificially inflating electricity prices to their contracted customers.
- That the burden would be on the utilities to provide proof of innocence rather than on the customer to provide proof of guilt.
- That price cuts would be forced, at least temporarily, before the utilities have had sufficient time to adequately respond to an accusation.

More paperwork, but ultimately, does anything really change?

Will the cartel office's increased authority make any tangible difference, in reality? We believe so, in that an increased rate of enquiries would imply greater labour requirements as utilities work on their response. Ultimately, however, the major factor remains the same as it always has been – the presence or the absence of evidence that the utility artificially inflated its prices. Cases have been brought against the utilities before, but there has been virtually no high-profile loss of any significance that we can identify. The switching of the burden of proof does not automatically imply that this will suddenly change, and we do not see a significant risk to E.ON or RWE.

7. EU investigation into alleged E.ON-GDF collusion

Gaz de France increase in German volumes appears a fair defence

The EU has launched a formal investigation into alleged collusion between E.ON and Gaz de France regarding the utilisation of the MEGAL pipeline, of which they are co-owners. MEGAL is Germany's largest capacity transit pipeline with 26BCM per year, connecting France with the Czech Republic through Germany. It was constructed in 1976.

The decision to go ahead with the enquiry follows European Commission raids on the offices of various gas companies during 2006. The allegation is that E.ON and Gaz de France agreed to keep out of each other's domestic market, thereby impeding competition and supporting prices. In theory, the European Commission can punish utilities through financial penalties of up to 10% of annual group revenues (currently €7bn for E.ON).

We believe that there was an agreement in place that expired before full liberalisation took place in Europe in July 2004. Since this time, Gaz de France has actively looked to raise its volumes in overseas markets (including Germany) in order to counter potential stagnation of sale in its home market.

We do not see a major threat from the EU's ongoing investigation, which may not reach a final conclusion for up to a year.

Conclusion – a more favourable environment now in place

We believe that the climate in German electricity has improved with the removal of the re-regulation threat, we see limited threat from upcoming regulatory and EU challenges, and we see electricity prices rising over the medium term, more fully reflecting the various component costs as investments on new generation capacity accelerate. We see annual average EBIT growth of 8% from E.ON's Central Europe West Power division, which includes its domestic electricity business.

Estimated breakdown of Central Europe West Power division EBIT

€m	2007e	2008e	2009e	2010e
German generation	2,565	2,918	3,174	3,402
German transmission	300	300	310	320
German distribution and supply	800	800	860	920
Netherlands, other west Europe	350	375	400	420
Total	4,015	4,392	4,744	5,062

Source: SG Equity Research

E.ON, with its balanced structure in terms of generation mix, client mix, and split between regulated and non-regulated, appears well placed. With visibility on the core business showing improvement, we can increase focus on prospects for E.ON to deliver on its 2007-10 investment plan outside Germany.

E.ON set to deliver on target of 10% annual EBIT growth on current structure

On 31 May, E.ON announced:

- 2007-10 expenditure (capex and acquisitions) of €60bn, plus a 10% share buyback.
- A target of 10% average annual EBIT rises between 2007 and 2010.
- A doubling of its so-called 'debt factor' (defined as net debt plus pension/nuclear provisions as percentage of EBITDA) from 1.5x in 2006 to around 3x from 2008.
- A commitment to 'concrete portfolio measures' (i.e. divestments) of assets failing to meet their financial and/or strategic objectives.

E.ON's 2007-10 capex plan, and investment assumed in our model

E.ON announced investments 2007-10	€bn	What we assume in our model	€bn
Acquisition of Endesa assets/Viesgo	10	We assume inclusion from 1/1/08	10.5
Organic growth in generation excl renewables	12	Assume some delay in CE West + Spain	11.0
Renewables	3	Existing build in renewables UK, D, Nordic:	0.7
		Energi E2 Renovables Ibericas	1.3
		Airtricity North America	3.0
Gas	10		
o/w upstream + LNG	>3	28% Skarv-Idun	1.7
		LNG Wilhelmshavn, Krk	1.0
o/w storage, networks	<7	Committed capex to 2010	2.0
Neighbouring markets	6	OGK-4 acquisition + new plant	5.0
Other growth	1		0.0
Maintenance + replacement	18		15.0
Buybacks	0	8% average €130	7.5
Total	60		59.2

Source: SG Equity Research

E.ON management has impressed with the speed at which it has implemented its 2007-10 plan. In particular, it has raised its growth, renewables, gas hedging, and risk profiles by its acquisitions of: i) Spanish and Italian assets from Endesa and Enel in 2008; ii) Wind farms on the Iberian peninsula and in North America; iii) 28% of the Skarv-Idun gas field in Norway; and iv) 70% of OGK-4 in Russia. It has simplified its structure by taking full control of E.ON Sverige by swapping Statkraft's 44.6% stake with selected generation plus a 2% stake in E.ON itself (currently held as treasury stock). E.ON reduces its reliance on its domestic market from 58% of 2008e EBIT to around below half by 2010e. We are happy at the competence of E.ON's corporate governance: in management's ability to move fast, get its message over, and show consistency.

Upgrade in our earnings forecasts

We have adjusted our estimates to take account of higher prices, the improved German operating environment, recently-announced acquisitions, and consideration of E.ON's cost-cutting potential in regulated activities. Our EPS is raised by an average of 9% a year.

- Upgrade in our assumptions of electricity and gas prices plus a better political context has brought 2008-09 EBIT rises of 1-2% for central Europe, 3-5% for pan-European gas, 1-2% for the UK, and 3-4% for Nordic (on a comparable basis).

- We also estimate that E.ON could generate €1.2bn of operational improvements in 2007-10, ahead of the €1bn advertised by the company on 31 May. In particular, we expect E.ON to be able to cut costs in its distribution business, where the current cost-plus mechanism is to be replaced by tariff-capping from 2009. In addition, the bundling together of all subsidiaries' trading operations (now to include those of E.ON Sverige, with E.ON having announced that it is to buy out Statkraft's 45% interest) should cut several hundred millions. This factor has led us to raise Central Europe EBIT by 1% from 2009.

We include the Endesa/Enel assets from January 2008, and assume that the Statkraft asset swap is valid from the same point.

E.ON forecasts (IFRS)

€m	2006	2007e	2008e	2009e	2010e	2011e
Sales	64,091	69,110	81,231	85,048	88,875	92,874
EBITDA	11,789	12,570	14,727	15,843	17,121	18,354
EBIT	8,356	8,994	10,501	11,322	12,283	13,218
Change on prev year	*+14.8%*	*+6.6%*	*+16.8%*	*+7.8%*	*+8.5%*	*+7.6%*
Change vs previous estimate	-	-	*+3.2%*	*+5.5%*	-	-
Central Europe	4,235	4,630	5,048	5,425	5,778	6,111
Central Europe West Power	3,550	4,015	4,392	4,744	5,062	5,365
Central Europe West Gas	272	245	264	275	289	300
Central Europe East	269	310	334	349	371	388
Other/consolidation	144	77	77	77	77	77
Pan-European Gas	2,347	2,361	2,474	2,582	2,742	2,912
Up-/Midstream	1,890	1,801	1,891	1,976	2,115	2,263
Downstream	457	560	583	606	627	649
UK	1,239	1,297	1,348	1,419	1,477	1,537
Nordic	512	712	619	669	711	756
Southern Europe + Lat Am	0	0	830	905	980	1,055
Russia	0	0	120	220	450	650
North America	426	368	399	438	482	533
Corporate Centre, other	-403	-374	-337	-337	-337	-337
Pre-tax profit	5,510	8,781	9,499	10,262	11,216	12,244
Net reported	5,307	5,392	6,125	6,836	7,477	8,168
Net adjusted	4,682	5,142	5,875	6,586	7,227	7,918
Ave number of shares in EPS calculation (m)	659.1	652.0	632.7	618.0	618.0	618.0
EPS adjusted (€)	7.10	7.89	9.29	10.66	11.70	12.82
Previous EPS adjusted (€)	-	*7.73*	*8.65*	*9.66*	-	
CFPS adjusted (€)	12.49	14.14	16.75	18.44	20.06	21.74
Ord DPS (€)	3.35	4.10	5.00	6.00	7.00	8.00
End-year net financial debt	(137)	(8,326)	(24,768)	(25,656)	(26,187)	(25,428)

Source: SG Equity Research

For 2007-10, we estimate average annual EBIT growth of 10%, similar to the targets given by E.ON in May. We expect to be in a position to raise this in future as E.ON carries out further acquisitions over the coming months and years.

Our new forecasts, previously near to IBES, are now on average 8-9% higher in 2008-09.

SG estimates higher than consensus

	SG	IBES	SG as % of IBES
EBIT (€m)			
2007e	8,994	8,802	+2.2%
2008e	10,501	9,807	+7.1%
2009e	11,322	10,514	+7.7%
EPS (€)			
2007e	7.89	7.88	+0.1%
2008e	9.29	8.82	+5.3%
2009e	10.66	9.55	+11.6%

Source: SG Equity Research

Further portfolio changes to raise E.ON growth profile

Growth markets' proportion of EBIT set to triple to at least 20% by 2011

While E.ON has for some time represented a sector benchmark in terms of its well-balanced and integrated nature, its success in absorbing acquisitions, and its financial strength, it has also been notable for its earnings dependence on mature markets, such as Germany, the UK, Scandinavia, and the US Midwest. Although strong in central and eastern Europe, markets offering demand growth of over 3% a year accounted for just 7% of E.ON's 2006 EBIT. This could be a factor behind E.ON's traditional discount relative to its peer group.

Recently announced acquisitions in Spain, Italy, renewables and Russia should raise E.ON's EBIT exposure to faster-growing segments to 20% by 2011, and a priority will be further expansion in these areas. Ultimately, we see at least a quarter of group EBIT coming from more rapidly developing areas and less than 40% from Germany.

Medium-sized moves likely at any time

E.ON's €60bn of intended 2007-10 investments excludes share buybacks, and so far we have been able to identify just €52bn of such expenditure, implying that E.ON has significant further moves to make.

The company has stated its objective of raising its 'debt factor', which is defined as net financial debt plus provisions as a multiple of EBITDA and represents its principal balance sheet measure, from 1.5x in 2006 to 3x by 2008 and beyond. According to our current estimates, it is not far short of attaining its target – our estimated debt factor is 2.83 for 2008. But there is substantial leeway for acquisitions after 2008. In addition, we doubt that the target is particularly rigid.

E.ON's debt factor still lags its objectives

€m	2006	2007e	2008e	2009e	2010e
Underlying cash flow	8,173	9,047	10,081	11,102	12,077
Capital expenditure	4,083	5,700	8,400	8,900	8,900
Acquisitions	7,067	10,600	16,000	500	500
o/w Endesa/Viesgo			10,000		
o/w Buybacks		2,800	5,800		
o/w coverage of pensions (CTA)	5,100	3,100			
Disposals	-3,954	-1,000	-500	-500	-500
Dividends	-4,703	-2,210	-2,623	-3,090	-3,708
End-year financial debt	-137	-8,326	-24,768	-25,656	-26,187
Nuclear provisions, other provisions	-18,094	-15,200	-16,954	-17,045	-17,145
End-year economic net debt (E.ON measure)	-18,231	-23,526	-41,714	-42,701	-43,333
EBITDA	11,789	12,570	14,727	15,843	17,121
Debt factor		2.00	2.83	2.70	2.53

Source: SG Equity Research

E.ON has the potential to make sizeable, but not blockbuster, acquisitions

If E.ON were to carry out further acquisitions at around 9x EV/EBITDA (given that E.ON's targets range from upstream, which if operational will be at a much lower multiple, to renewables, which are likely to be at a much higher multiple), then we calculate that in order to achieve a debt factor of 3 for each year, it has leeway to make €3.5bn of acquisitions by the end of 2008, or €7.5bn by the end of 2009, or €12bn by the end of 2010. That said, we would make the following observations:

- E.ON can raise further funds for acquisitions by selling assets it deems non-strategic or non-performing, and/or by paying a lower dividend than what we are assuming (based on a 60% pay-out).
- It could also exceed the 3.0x debt factor target.
- By the end of the decade, E.ON is likely to commit significant funds (several billion pounds sterling) to new gas pipeline and storage projects returns, which will be realised after several years.

Potential acquisition targets for E.ON

Company/activity	Asset to be sold	EVe €bn	Method of acquisition	Comment
Distrigaz	61% stake to be sold by Suez	€1.7bn	E.ON could offer 36% Gasag stake + c€1.2-1.5bn or other German gas assets	Possible: although Suez wants full asset swap ahead of cash and EDF has the assets Suez would most want, EDF could be thwarted by political considerations
Belgian generation	300MW nuclear + 1500MW thermal, to be sold by GDF Suez	€1.3bn	Swap with E.ON capacity in Germany?	Possible: although Suez wants full asset swap ahead of cash and EDF has the assets Suez would most want, EDF could be thwarted by political considerations
Upstream	25% Yuzhno Rosskoye?	€3-4bn	Cash, perhaps + 50% E.ON Hungary	Difficult negotiations for Gazprom for an asset that would solve E.ON's gas hedging inadequacies and provide a hedge for OGK-4 (large gas consumer)
Upstream	Alternatives to Yuzhno Rosskoye	€3-4bn	Operational fields adding 5BCM E.ON share of output	Depends upon outcome of Yuzhno Rosskoye. E.ON needs to double annual self-produced gas to reach its 15% hedge target
Renewables	Acquisitions	€1-2bn	Cash	E.ON appears to have raised its aspirations in renewables, and is likely to make further moves given growth + favourable regulation
Union Fenosa	40% ACS stake	€7.5bn	Cash, to raise E.ON market share to 15% in Spain	Difficult: complex change-of-ownership issues linked to Union Fenosa Gas; also, political issues. Does E.ON have the stomach for another Spanish fight?
Dutch utilities	Nuon-Essent merger cancelled, potential targets	€5-7bn	Cash	Difficult: attractive market, but companies need to be unbundled before any possibility of bid. Political and local opposition to unbundling + selling to foreign utilities
East Europe	Romania, Balkans, Bulgaria	€2bn	Cash	Likely: upcoming power distribution privatisations in Romania, partial privatisations of State gas companies (Romania, Bulgaria)
New markets	Turkey	€1bn	Cash	Regional privatisations for 2008?

Source: SG Equity Research

Yuzhno Russkoye, conclusion of negotiations would be helpful

The major decision to be made in the near term concerns the giant gas field Yuzhno Rosskoye.

In 2005, E.ON's upstream gas production amounted to less than 1% of its 63BCM total requirements (of which 52BCM in Germany). Much of this output is concentrated in the UK and Norwegian North Sea.

- In the UK, output is rising strongly from 0.4BCM in 2005 due to a full year's contribution from Caledonian (from only two months in 2005) and the 2006-07 start of output at Glenelg and West Franklin (satellite fields of Elgin and Franklin, relatively modest in size).

- In Norway, E.ON-Ruhrgas owns 30% of the Njord field, which has been producing oil and which from 2007 is producing modest volumes of gas.

- In Norway, E.ON has acquired a 28% stake in the Skarv and Idun fields, bringing over 1BCM per year from 2012.

Altogether, these projects should bring annual output to around 4BCM, or 7% of 2006 gas needs. A 25% share of the output of Yuzhno Russkoye (plateau production of which will be of the order of 25BCM) would give an additional 6.2BCM of production, equivalent to 9.5% of E.ON's gas needs, bringing E.ON up to its target of 10BCM of annual upstream output. A 15% share of the Yuzhno Russkoye would bring E.ON to 8BCM of annual output.

In this one deal, E.ON's self-sufficiency could therefore (if we assume a 25% stake) increase from 7% to almost 17%. But almost 60% of its gas production would then come from Russia, in addition to the one-third of gas purchases likely to be sourced from Russia over the medium-term following extension and increase of contracts with Gazprom concluded in August 2006.

Impact of Yuzhno Rosskoye on E.ON's upstream gas position

	Peak annual output BCM	As % of 2006 gas requirements	As % of 2012e gas requirements
2005 gas output	0.4	0.7	0.6
Increase in production from existing North Sea holdings, before acquisition of Skarv and Idun	2.6	4.1	3.6
Skarv + Idun, from 2012	1.4	2.2	1.9
Yuzhno Russkoye 25% interest	6.2	9.5	8.5
E.ON's upstream gas hedge	10.6	16.5	14.6

Source: SG Equity Research

Yuzhno Russkoye could be a hugely valuable field

The value to be created from investment in Yuzhno Russkoye depends very much on the delivered price for gas in western Europe. In the table below, we estimate the NPV of the field, and its simple payback period, at various long run oil price assumptions, and associated continental gas prices.

As can be seen, even with substantial export duties imposed by the Russian government on gas sold to western Europe, the investment appears to be very attractive at most oil price scenarios. If we take a long-term assumption of $40-50/boe, then a 25% stake in Yuzhno-Russkoye could be worth €5bn.

Yuzhno-Russkoye estimated valuation at a variety of long-term oil prices

Oil price $/boe	Approx European gas price $/Mbtu	Gas export duty $/Mbtu	Capex costs $/Mbtu	Gross profit $/Mbtu	NPV $bn	Simple payback (years)
80	11.5	-3.5	-1.3	6.7	61	1.5
70	10.2	-3.1	-1.3	5.8	53	1.6
60	8.8	-2.6	-1.3	4.9	45	1.9
50	7.5	-2.3	-1.3	3.9	33	2.4
40	5.8	-1.7	-1.3	2.8	26	2.9
30	4.0	-1.2	-1.3	1.5	14	4.2
20	2.3	-0.7	-1.3	0.3	3	7.3

Source: SG Equity Research

Acquisition of OGK-4 is a useful addition for E.ON in its negotiations with Gazprom

It appears that Gazprom has returned to the negotiating table demanding better terms than those previously implied, citing the rise in energy prices. It is now for E.ON either to accept these terms, thereby solving its hedging shortfall and complementing its acquisition of OGK-4, or walk away and look for acquisitions of upstream assets elsewhere at a time of very high oil prices.

Without wishing to pre-judge the outcome of negotiations with Gazprom, we would judge that E.ON's entry into the Russian power sector has improved its position and its hopes of finally obtaining its Yuzhno Russkoye stake.

Russia – market sees growth prospects, but underplays the risk?

The market appears to have accepted that Russia represents a country that is sufficiently attractive in terms of growth potential for relatively high prices to be paid by overseas acquirers in spite of the risks involved. This was the case when E.ON paid $750/kw for OGK-4, taking on trust the Russian Government's targets of more than doubling domestic gas and electricity prices by 2011. In addition, closer operational links to Gazprom through projects such as the North European Gas Pipeline (NEGP, in which E.ON has a 25% stake), Yuzhno Russkoye, and Gazprom's status as major supplier to OGK-4, could push for more value to be put on the 6.4% shareholding E.ON retains in Gazprom. A resolution of the Yuzhno Russkoye negotiations would in our view be preferable, assuming that the price paid can be adequately justified, to E.ON walking away and perceived to be on the hunt for scarce, and probably over-expensive, upstream assets in other areas.

Eastern Europe – E.ON to expand, boosting growth profile

Strength of existing positions in central/eastern Europe opens up potential for economies from new moves

E.ON has already carried out much of the groundwork in central and eastern Europe, providing it with potential to generate economies from new acquisitions in the area. At its capital markets day in Budapest on 20 September 2007, E.ON underlined the growth potential of central and eastern Europe, by which it means the Baltic States, Poland, the Czech Republic, Slovakia, Hungary, Romania, Bulgaria, Slovenia, Serbia, Croatia, Macedonia, Bosnia-Herzegovina and Albania.

E.ON expanding in countries with higher demand growth profile

CAGR % 2005-15	Electricity demand	Gas demand
Central and Eastern Europe	+3.4%	+4.1%
Iberian Peninsula	+3.0%	+5.2%
Italy	+2.3%	+1.3%
Average Germany, Nordic, UK (E.ON's principal markets)	+1.4%	+1.6%

Source: E.ON

E.ON also indicated its interest in upcoming or anticipated privatisations – we would expect it to look to acquire one or two of the three remaining Romanian electricity distributors still to be sold off. All three adjoin E.ON's existing operating area in the north east and we estimate the potential acquisition price of each at €300-400m.

Potential opportunities in Romania

Company	Region	Customers (m)	Sales 2005 (TWh)
E.ON Energie Romania	North east	1.2	3.8
Upcoming privatisations			
Muntenia Nord	East	1.2	3.6
Transylvania Nord	North	1.2	3.4
Transylvania Sud	Centre	1.0	3.8
Total market		8.6	28.5

Source: E.ON

As with renewables, E.ON raises its exposure to growth markets by adding to its existing central and East European positions. It benefits from its existing leading positions in these countries.

E.ON's strong central and eastern European positions

Region/activity	E.ON market share and position
Czech power and gas retail	No 2
Slovakia power and gas retail	No 1 power, 24.5% stake in No 1 gas
Hungary power and gas retail	No 1 power, No 3 gas
Bulgaria power retail	No 3
Romania power and gas retail	No 3 power, No 2 gas
Central + eastern Europe gas storage	Stakes in companies with 35% share
Central + eastern Europe gas purchase	Stakes in companies with 31% share

Source: E.ON

Liberalisation should, over time, bring price rises as retail tariffs steadily catch up wholesale prices, which in many cases are close to those of Germany. We are happy that E.ON, currently overly biased toward distribution in its power activities in the central and eastern European regions, is improving its (currently inadequate) level of integration by investing in new generation with a view to covering half of demand through its own generation (similar to Germany).

More renewables investments

We believe that E.ON has not yet completed its moves to build a strong position, and in particular a strong pipeline, in renewable energy. With the sharp rise of the EDF Energies Nouvelles share price, the flotation of Iberdrola's renewables activities, and RWE's statement that it will now look at expansion in renewables under its new CEO Grossman, a veritable feeding frenzy looks to be taking place, with the prevailing view that regulation will remain very favourable.

There are many possibilities for acquisition, though Airtricity was a particularly attractive and large player, bought by E.ON by outbidding another European utility looking for 50%. There are three types of opportunity:

1) Companies owned by financial investors such as Horizon, bought by EDP

2) Non-listed companies such as EnergyE2 (DONG) bought by E.ON

3) Listed players, such as Greentech in Denmark, with assets in Italy and Greece.

Benelux: more optimistic in Belgium than in Netherlands

Long-standing relations with GDF could improve chances of gaining Distrigaz

E.ON has expressed interest in Distrigaz, 61% owned by Suez and to be sold as a condition for its merger with Gaz de France to go through. We believe that E.ON might be willing to offer its 36% stake in Berlin-based Gasag as part of a deal. This could be of interest to GDF Suez, since it would then own 68% of Gasag. But we estimate that Suez's Distrigaz stake is worth €1.2-1.5bn more than E.ON's Gasag interest. E.ON could look to offer GDF Suez other gas interests in Germany, such as access to its storage. Germany is a priority market for GDF Suez's expansion plans. It has links with E.ON through their joint ownership of the MEGAL transit pipeline (bringing Russian gas across Germany to the French border), and E.ON and GDF co-own 49% of SPP, Slovakia's dominant gas distributor. For E.ON, getting Distrigaz would be a major advance, diversifying its procurement portfolio away from Russia and adding access to the Zeebrugge hub.

E.ON is far from the only company interested in Distrigaz. Its chances of success depends on whether Suez wants to swap Distrigaz with gas assets (which would seem logical) or whether it would be willing to bundle Distrigaz with the Belgian generation assets it must sell (300MW of nuclear and 1.5GW of thermal) and swap them with something we know that Suez wants – nuclear capacity in France (implying a swap with EDF, although Belgian Flemish political objections could jeopardise this). We doubt that Suez has interest in any power assets of E.ON, although we would expect E.ON to express its interest in the Suez generation capacity – this after all represents a one-off chance to acquire operating nuclear capacity, and it addresses E.ON's inadequate Benelux position (a distant number four behind Suez, Essent and Nuon).

Collapse of Essent-Nuon merger unlikely to bring near-term opportunity

Further opportunities could arise in the Netherlands now that the merger plan between Essent and Nuon has been called off. We estimate the non-regulated parts of these companies to be worth €5-7bn. For either Essent or Nuon to become available

1) The unbundling of their distribution networks has to take place (there appears no hurry in this respect, and ultimately it could depend on the progress of the EU's objectives to force through unbundling).

2) The provinces, which own Essent and Nuon, have to agree to sell their stakes sufficiently for E.ON (or others) to come in – there is no agreement.

E.ON would compete against RWE and others for any Benelux assets to become available. For us, its major chance would be to obtain Distrigaz. This would be a major positive, in our view.

E.ON wants to become bigger in Spain ... but once bitten, twice shy?

E.ON will have around 7% of Spanish generation and 4% of electricity distribution/supply, putting it in a distant fourth place behind Endesa, Iberdrola, and Union Fenosa. We doubt that E.ON will be particularly happy with such a minor position, but, having been badly bruised by its failure over Endesa, may elect to bide its time.

Nonetheless, changes may take place. Whilst any changes in the Gas Natural shareholding structure could see the reinforcing by Suez of its position, there seems to be little or no financial and industrial logic for ACS, a construction company with net gearing of 268% at the end of 2006, to own stakes in both Iberdrola and Union Fenosa (which are unlikely to receive the political green light or Iberdrola approval to merge).

We cannot see E.ON looking at ACS's 11% stake in Iberdrola, since i) it would have no hope of taking control, and ii) the political outcry would be overwhelming. It is not E.ON's policy to take minor holdings in large, independent-minded power companies.

If ACS elects to sell its Union Fenosa stake of 40.5% (which, lest it be forgotten, ACS fully consolidates), there are two potential issues:

1) The position of the two local (Galician) and other regional banks, none of which hold more than 10% individually but which own 30.3% combined. In order to ward off E.ON, a new rule was put through by which any owner of more than 10% of a utility has to convince the CNE of its expertise in energy supply, something a local bank is unlikely to be able to do.

Union Fenosa's main shareholders

Shareholder	% held
ACS	40.470
Caixa de Ahorros de Galicia	9.999 (from 8% in April)
CXG Corporacion Galicia	9.993
Caja de Ahorros del Mediterraneo	5.150
Inversiones Cotizadas del Mediterraneo	5.150
Total Spanish institutions	70.762

Source: CNMV website Note: Caixa de Vigo (Caixanova) held 5% and Banco Pastor 4% according to a Corporate Governance filing with the CNMV on 25 May

2) Much of the interest in Union Fenosa is in Union Fenosa Gas, jointly owned by Union Fenosa and Eni, and its fastest-growing part. Despite much confusion and lack of clarity, there is a clause (from a 2003 US SEC filing) which would allow Eni first refusal to buy the Union Fenosa stake at a 10% premium (i.e. an attractive price) to what it paid for its 50% interest in 2002. Eni has said that it would want to take up this option.

The situation is highly complex, and for E.ON it could be a case of once bitten, twice shy. We have strong doubts that it will commit major funds and efforts in fighting another battle in Spain.

What risk of perception of E.ON overpayment?

We do not see E.ON damaging its share rating through destroying significant value by overpaying for an asset. Following its recent acquisitions and those we know are to come (Endesa/Enel assets), there seems little likelihood of E.ON carrying out a blockbuster move.

Russia – Solution needed on Yuzhno Russkoye to avoid need for alternative upstream moves

The major risk is Russia, where E.ON paid what we believe was a generous $750/kW for OGK-4 in view of the early stage of Russian liberalisaton and the assumption of 20%-plus average domestic power and gas prices. We have written-off a quarter of the value of the investment in our model, but the share price barely moved on the news of the acquisition price. If E.ON pays cash for a stake in Yuzhno Russkoye, which we see as potentially a very valuable field, there could be a reaction, but this would be short-lived in our view given: i) The calm reaction to OGK-4; and ii) the fact that E.ON would find itself adequately hedged in gas production with no pressure to look for other acquisitions of upstream assets at a time when oil is at $80/barrel. Therefore, the risk would be greater if E.ON fails to reach agreement with Gazprom over Yuzhno Russkoye.

Renewables – E.ON paid a full but not excessive price for Airtricity

We estimate that E.ON's acquisition of Airtricity's North American wind assets and capacity pipeline was made at a reasonable price of €1.35m/MW, based on a probability approach. The transaction price in terms of EV per MW of installed capacity was €4.7m, at a 10% discount to the market value of EDF Energies Nouvelles (Hold, 12-month target price €51).

E.ON paid a fair market price for Airtricity assets

Wind Capacity	MW	Probability of completion	Probability-weighted MW
Installed capacity (MW)	214	100%	214
Under construction (MW)	880	90%	792
Advance development stage (MW)	1,000	60%	600
Early development stage (MW)	5,000	20%	1,000
Total probability-weighted capacity (MW)			2,606
Purchase price (€m)			1,000
Total purchase cost (incl. construction costs) (€m)			3,500
Average cost (€/MW)			1.35

Source: SG Equity Research

E.ON could fund expansion via up to €15bn of disposals

E.ON states "if individual assets do not contribute in line with financial and strategic expectations, E.ON will take concrete portfolio measures". It will "review its entire asset base to ensure that by 2010 all assets in the portfolio deliver the expected financial/strategic value contribution".

Potentially, up to €15bn of disposals could be made as E.ON adds focus to its strategy. Some will be carried out as asset swaps, others for cash.

Potential asset disposals

Asset	Value €bn (e)	Comment
Gazprom	4.0	Would be part of a wider deal (OGK-4? Yuzhno Russkoye?)
LG&E	6.8	Generates sound financial returns, but isolated in context of group structure
Electricity transmission grid	2.2	May be sold regardless of EU position
Associates	c2.0	New regulation to lead E.ON to sell minority interests in distributors
Total	15.0	

Source: SG Equity Research

Statkraft swap shows a proactive approach

We have seen recent evidence of E.ON's determination to get maximum strategic and financial benefit from its investments. The swap arranged with Statkraft, whereby Statkraft takes 2% of E.ON (currently held as treasury stock) plus E.ON generation assets in Germany, Sweden, the UK and Poland while E.ON takes the 44.6% of E.ON Sverige (EV estimated at €4bn) that it does not own, allows E.ON full control of its Nordic portfolio, eliminates the potential that previously existed for conflicts of interest with Statkraft, reduces minority elements, and improves conditions for E.ON to integrate all of its European trading activities.

Gazprom stake locks up too much capital – to be partially sold?

E.ON management having signalled a proactive approach toward making "portfolio changes" if assets fail to meet the group's strategic or financial aspirations, and then having backed up its words with the Statkraft swap, the obvious candidate for at least a partial disposal is its 6.4% Gazprom stake, currently worth €13bn. This is still inadequately reflected in the E.ON share price, and we believe that E.ON could look at selling part of its interest, probably the 1.9% part (worth €4bn) that is held indirectly through a 50:50 joint venture (we believe with a subsidiary of Gazprom itself). Only when the stake is monetised, or swapped with assets, is it likely that a fuller value will be ascribed to it by the market.

Any disposal of the stake would be likely to represent part of a wider transaction, which could involve OGK-4 or Yuzhno Russkoye. E.ON would thus not be seen to jeopardise its close and longstanding relations with Gazprom. We do not expect that Gazprom would look to buy back the shares itself.

The market has talked about the possible disposal of Gazprom shares for some time. Now it would appear that the conditions are more appropriate for a partial exit. This should be taken favourably.

LG&E a candidate for disposal on grounds of lack of strategic value

LG&E (€6.83bn capital employed) meets E.ON's financial criteria, and performs well compared with its peer group in US regulated utilities, achieving a return on equity close to its permitted maximum of 11%. That said, if E.ON is looking for disposals to fund acquisitions in areas of growth, then LG&E, being regulated, slow-growing, and not in Europe, would look to fit the bill in that it may well be deemed not be delivering strategic value to the wider group.

E.ON Netz could be sold, either by obligation or by choice

We also believe that E.ON could decide to sell part or all of its German electricity transmission business E.ON Netz (for which we estimate an EV of €2.2bn), on the basis that better financial returns can be achieved in its non-regulated businesses. This decision could be forced on the company if Germany accedes to the EU's wish that ownership of regulated transmission assets is taken away from generator/suppliers.

A more active approach to equity investments, i.e. minority holdings in domestic distributors

E.ON should also be taking an active line regarding the justification for its equity holdings, worth €7.9bn in the 2006 balance sheet. Much of this consists of stakes in a multitude of German local distribution utilities, held via the fully-owned Thuga. We believe that the upcoming implementation of the new cost-incentive tariff system in distribution will bring a shake-out of the sector, and that E.ON will prefer to concentrate on its large regional distributors, such as E.ON Hanse or E.ON Bayern, which are majority or fully owned. We expect E.ON to sell down many of the minority stakes in distributors held via Thuga. As a general rule, we see E.ON prioritising generation, which we clearly expect to be the most profitable part of the power sector, and de-emphasising distribution, where the days of ample returns are over, to be squeezed by the regulator.

Valuation – 12-month target price of €150

We have upgraded our target price on E.ON from €135 to €150. We base this on sum-of-the-parts (SOTP), discounted cash flow (DCF), and peer group comparison assessments.

Sum-of-the-parts = €150

We prefer a SOTP approach for E.ON, which seems appropriate given its various utility activities in different countries, and have raised our SOTP valuation on E.ON from €135 to €150. This is due to the following:

- Our significant upgrade of European power forecasts has brought a rise of €6 per share.
- Our upgrade of oil prices together with more information on E.ON's central European businesses has brought a rise of €4 per share.
- Other elements such as the shareholding in Gazprom and a downgrade in our net debt assumption have brought a rise of €6 per share.
- We have written off 25% of the acquisition price of OGK-4, or €1 per share.

E.ON – Sum-of-the-parts

Utilities	Valuation methodology	€m	% of gross sop	€ per share
Electricity: nuclear generation	9898MW @ €1.15m EV/MW	11,382	10%	18.9
Electricity: thermal generation	35,956MW @ €0.85m EV/MW	29,628	26%	49.2
Electricity: hydro + wind generation	4,600MW @ €1.25m EV/MW	5,520	5%	9.2
Gas and oil production	5x 2007 EBITDA (€600m e) + equity interests	4,300	4%	7.1
OGK-4	75% acquisition EV	3,075	3%	5.1
Airtricity North American assets	Acquisition price	991	1%	1.6
Total upstream		*54,896*	*48%*	*91.2*
Retail - gas, electricity	25.4m direct + 15m indirect power/gas accounts @ €280/acct	7,944	7%	13.2
Electricity high-voltage grid	18820km high-voltage @ €109,000/km, 10% discount	2,185	2%	3.6
Electricity medium + low-voltage grid	385000km @ €20,000/km, 10% discount	7,107	6%	11.8
Gas network, storage, reserves	11,280km high-pressure, 55,000km distribution, storage	8,147	7%	13.5
Ruhrgas	6x 2007e EBITDA excl upstream, less value of network	13,795	12%	22.9
Total distribution + supply		*39,179*	*34%*	*65.1*
Gazprom	6.4% stake = 82.9m direct + 49% of 69.4m - ADR price	13,153	12%	21.8
Other associates + financial l-t investments	2006 annual rpt pages 146-7	7,150	6%	11.9
Total other activities		*20,303*	*18%*	*33.7*
Total gross assets		**114,377**	**100%**	**190.0**
Group net cash/(debt)	End-2007e	(8,326)		-13.8
Nuclear + pension provisions	End 2007e	(15,350)		-25.5
Minorities, treasury stock, other	After Statkraft swap	(187)		-0.3
Total sum-of-parts		**90,515**		**150.4**
Sum-of-parts per share		**150.36**		

Source: SG Equity Research

We assume a nuclear phase-out after an average of 32 years' average operating life in Germany. A reprieve and output extended to 50 years would add around €9 per share to our valuation.

We apply no discount to E.ON SOTP, in view of the clear business and financial strategy.

Discounted cash flow = €150

Our standard DCF model takes an explicit forecast period of five years to 2011 followed by a normalised six-year period to 2017 and then a 1% growth rate to perpetuity. Based on a 4.42% risk free rate, a market risk premium of 4.08%, and a stock beta of 0.90, we obtain a WACC of 6.6% and a per-share DCF valuation of €151. The 11% increase in valuation results primarily from the upgrades in our earnings forecasts.

We take a perpetuity growth rate of 1% for all utilities

DCF assumptions

Valuation (€m)		Weighted average cost of capital (%)	
Enterprise value	103,642	Risk-free rate - long-term bonds	4.42
o/w forecast period (%)	*41.0*	Market risk premium	4.08
o/w terminal value (%)	*59.0*	Beta	0.9
		Cost of equity	7.9
Net debt (-)/cash (+)	-16,903	Cost of debt after tax	3.1
Value of minorities	0	WACC	6.63
Value of associates	0	Normalised revenue growth (%)	2.5
Value of marketable assets	0	Normalised EBIT margin (%)	13.4
Other adjustments	0	Normalised cash conversion rate (%)	78.4
Value of equity (DCF)	**96,439**	Average cash conversion rate 03/09 (%)	73.0
SG DCF value/share (€)	**151**	CF perpetuity growth rate (%)	1.0

Source: SG Equity Research

DCF details

(€m)	Forecast period (five years)					Normalised forecast period (six years)					
	12/07	12/08	12/09	12/10	12/11	12/12	12/13	12/14	12/15	12/16	12/17
Revenues (bn)	69.11	81.23	83.26	85.34	87.48	89.66	91.90	94.20	96.56	98.97	101.45
Revenue growth (%)		17.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
EBIT (bn)	8.99	10.50	11.12	11.39	11.68	11.97	12.27	12.58	12.89	13.21	13.54
EBIT margin (%)	13.0	12.9	13.4	13.4	13.4	13.4	13.4	13.4	13.4	13.4	13.4
Depreciation	3,576	4,227	5,120	5,248	5,379	5,514	5,652	5,793	5,938	6,086	6,239
Taxes	-2,518	-2,940	-3,112	-3,190	-3,270	-3,352	-3,436	-3,521	-3,609	-3,700	-3,792
Capex	-5,700	-8,400	-8,615	-8,805	-8,000	-8,200	-8,405	-8,615	-8,831	-9,051	-9,278
Capex as % of sales	-8.2	-10.3	-10.3	-10.3	-9.1	-9.1	-9.1	-9.1	-9.1	-9.1	-9.1
Change in working capital	366	1,142	96	99	101	104	106	109	112	115	117
Other operating cash mvts	0	0	0	0	0	0	0	0	0	0	0
Free cash flow	4,718	4,529	4,605	4,745	5,889	6,036	6,187	6,342	6,500	6,663	6,830
EV/IC (x)	1.6	1.5	1.5	1.4	1.3	1.3	1.3	1.2	1.2	1.1	1.1
ROIC/WACC (x)	1.5	1.7	1.7	1.7	1.6	1.6	1.6	1.6	1.6	1.6	1.6

Source: SG Equity Research

E.ON's DCF value would rise by 11% with a 50bp cut in its WACC and fall by 9% with a 50bp increase

Sensitivity analysis

		WACC (%)				
		5.63%	6.13%	6.63%	7.13%	7.63%
CF perpetuity growth rate (%)	0.1%	165	149	136	125	115
	0.6%	176	158	143	131	120
	1.1%	189	168	**151**	137	125
	1.6%	206	181	161	145	132
	2.1%	227	197	174	155	139

Source: SG Equity Research

P/E, EV/EBITDA and yield relative to peer group

E.ON's 2007-09 EPS growth, at 16% similar to that of RWE, is at a 50% premium to the sector. With Germany less uncertain, and with the portion of EBIT in what could be termed higher-growth markets set to rise from 7% in 2007e to over 21% by 2011e while Germany's share of EBIT declines from over 58% to around 45% during the same period, there seems little reason for the share's 20% 2009 and 5% EV/EBITDA discount to our European universe.

E.ON's discount too wide

Prices as of 22 October 2007	P/E 2008e (x)	P/E 2009e (x)	EV/EBITDA 2008e (x)	EV/EBITDA 2009e (x)
E.ON (€131.3)	14.1	12.3	8.3	7.8
RWE (€92.5)	13.5	11.8	6.9	6.4
Germany	13.9	12.2	7.8	7.3
Sector	17.0	15.4	8.8	8.2
E.ON discount rel to sector	17.1%	20.1%	5.7%	5.0%

Source: SG Equity Research

On PEG multiples, E.ON trades at an average of 0.8x 2008-09, RWE at 0.75x, and the sector as a whole at around 1.5x.

We are happy with the degree of visibility for E.ON in 2010 and 2011, yet the shares trade at just 11x 2010e earnings and 10.1x 2011e.

Widening yield premium

E.ON's ordinary dividend policy is to pay out 50-60% of adjusted net income. The dividend can be used as a way toward E.ON achieving its targeted 'debt factor' of 3x by the end of 2008. In our model, we have assumed that E.ON increases its payout to the 60% mark by 2010, implying a more than doubling of the dividend between 2006 and 2010. This implies increasingly attractive yields, with E.ON providing an increasing premium relative to the sector.

E.ON's yield increasingly attractive

Prices as of 22 October 2007	2006	2007e	2008e	2009e	2010e
E.ON ord dividend (€)	3.35	4.10	5.00	6.00	7.00
RWE ord dividend (€)	3.50	4.20	4.00	4.50	5.00
E.ON yield (€131.3)	2.6	3.1	3.8	4.6	5.3
RWE yield (€92.5)	3.8	4.5	4.3	4.9	5.4
Sector yield		3.4	3.6	3.9	4.3
E.ON yield premium		-8.9%	5.5%	17.9%	23.3%

Source: SG Equity Research

Risks to our valuation

Downside risks to our 12-month price target (and buy recommendation) include the following:

- We could be too optimistic on our power price forecasts, which are based on higher oil, coal and CO2 estimates. Lower power prices would weigh on sector performance, in particular those long on generation such as RWE, Fortum, EDF, and Verbund.
- We (and the market) expect that the German utilities will have to purchase at least 80% of their CO2 requirement from 2013. If harsher targets are set then this could weigh.
- We could be wrong in that E.ON could bid for assets (such as the 40% of ACS in Union Fenosa) at a price that appears too generous – this would damage the reputation, won back by management, of safeguarding its own shareholders interests rather than those of its targets.

Normalised growth analysis and three-year fair value

Normalised data is a way to calculate a three-year valuation, which is a standard horizon for investors with a medium-term horizon. It is also possible to use another methodology to calculate this three-year fair value.

Normalised data

Normalised EBIT margin	11.5%
Spread with 2007 EBIT margin	1.6%
Normalised 2007 EPS	9.69
Spread with 2007 EPS	22.8%
Normalised growth	2.6%
Organic growth	2.5%
Additional revenues from self-financed acquisitions	€1.8bn
Potential accretive impact from buybacks	4.7%

Source: SG Equity Research

Three-year fair value

Normalised P/E = current valuation/normalised 2007 EPS	13.2
Three-year FV = normalised three-year EPS x normalised P/E	155.0
Expected annual performance = spread between current price and 3-year FV	6%
Expected total return = expected share performance + dividend yield	10%

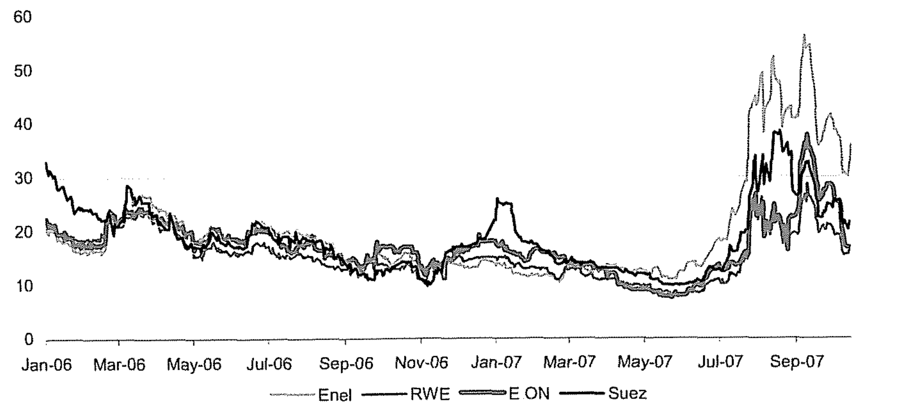
Source: SG Equity Research

Cross Asset Research

Should we hedge an alternative scenario?

Following its failed bid for Endesa, E.ON substantially raised its investment programme to €60bn over 2007-2011. The company expects to spend €9bn in 2007 and €23bn in 2008 (including the agreed €10bn on assets from Enel/Endesa). E.ON has limited bond redemption maturity in the short term: none by the end of 2007 and only €285m in 2008. To meet its substantial funding needs (share buyback and higher dividend yield included), E.ON indicated that it will tap the bond, CP and loan markets. E.ON will therefore adopt a more leveraged financial structure, hence our credit analysts' negative credit view. However, management is strictly committed to maintaining a mid-A rating.

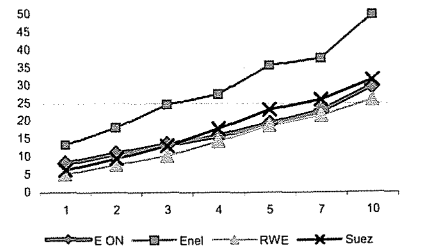
E.ON 5yr CDS back to the previous crisis level (bp)



Source: CMAN, SG Cross Asset Research

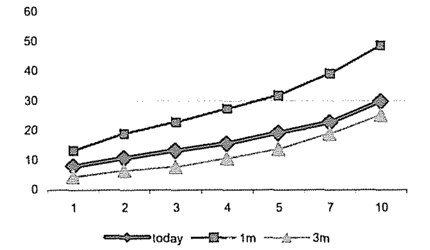
The E.ON 5yr CDS spread traded at a higher level than the Suez and RWE spreads for a while, but over recent weeks the credit spread has seen a nice outperformance relative both to peers and the utility sector. SG credit analysts initiated a sell rating on the 5yr CDS on 2 October when the spread was trading at 29bp.

E.ON credit structure vs peers (bp)



Source: CMAN, SG Cross Asset Research

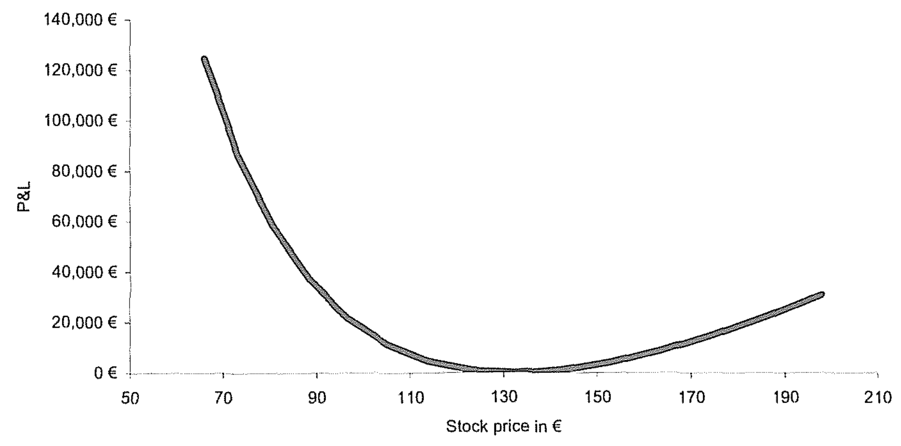
E.ON credit spread structure (bp)



Source: CMAN, SG Cross Asset Research

Despite limited reinvestment risk – no big acquisitions are planned for the coming years – we believe that, at the current 5yr CDS level, buying €10m CDS vs €141,000 nominal in stock could prove to be an interesting and relatively cheap idea to hedge a long cash position.

Long E.ON vs Long €10m 5yr CDS

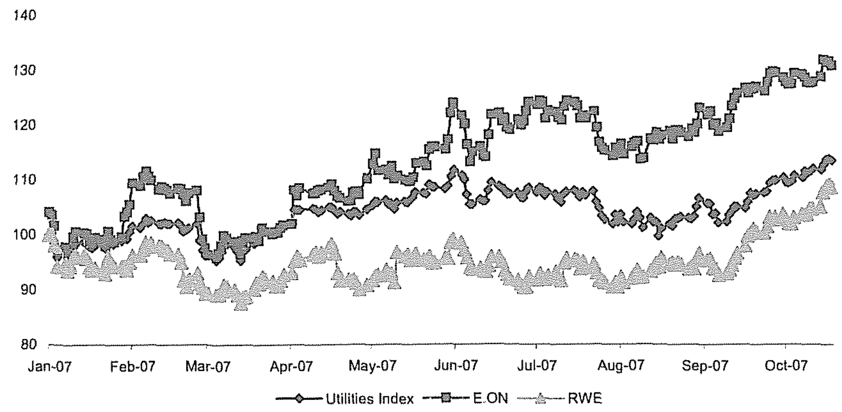


Source: SG Credit Quantitative Research

Relative value – E.ON vs RWE

SG's equity analysts believe E.ON offers stronger medium-term value than RWE, benefiting from a more balanced business structure and a surer industrial and financial strategy. In the near term, however, it is RWE – which has underperformed E.ON by 10% over a year – that could well outperform, due to its imbalanced structure that will allow it to benefit more fully from higher German power prices. RWE also trades at a discount of around 10% to E.ON on P/E and EV/EBITDA on our SG equity analysts' new estimates (EPS 2009e raised by 19.0% for RWE and by 11.6% for E.ON). In addition, RWE benefits from the apparent market approval (which we share) of the perception that its new CEO will adopt a more expansive strategy.

Absolute performance rebased to 100 in January 2007

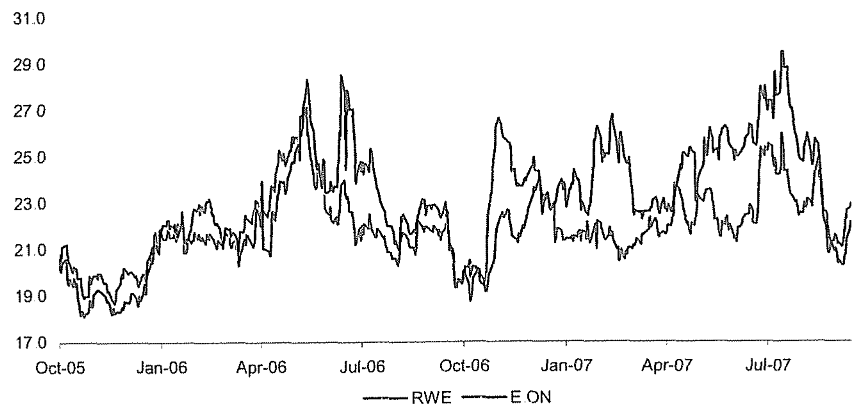


Source: SG Equity Research

Therefore, in the short term we believe a switch from E.ON to RWE would be of interest. We have identified different ways to play a relative value strategy.

We looked at a volatility pair trade and then at the cash equity spread. The RWE-E.ON 3-month at-the-money (ATM) implied volatility spread (%) does not look attractive at the current level.

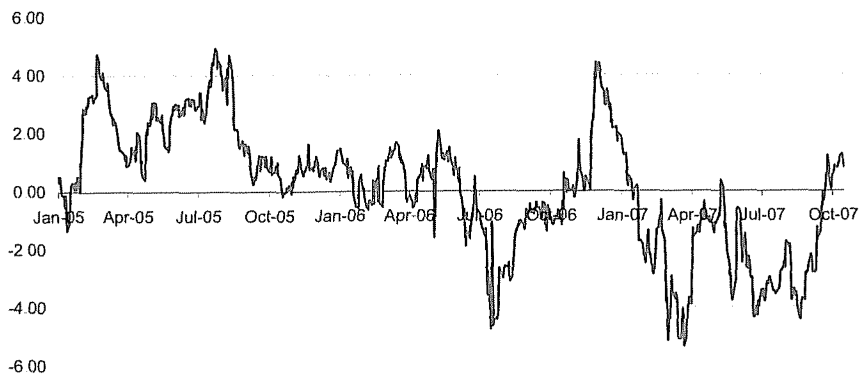
E.ON and RWE 3-month at-the-money implied volatilities (%)



Source: SG Equity Derivatives Research

Since August, both implied volatilities have dropped by 10pt for E.ON vs 5pt for RWE, but both 3-month ATM implied volatilities stand at a higher level than the historical volatilities.

RWE - E.ON 3-month at-the-money implied volatility spread (%)

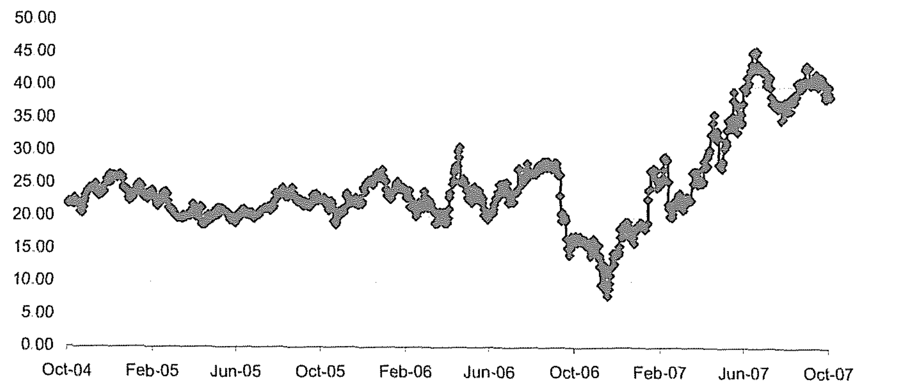


Source: SG Equity Derivatives Research

It seems more worthwhile to benefit from the spread between the two stocks using cash. E.ON has performed well since the start of the year and the large share buyback programme already seems to be priced in at least. RWE look more attractive in terms of valuation. Both companies have similar market risk – the beta for RWE is about 1.0 while it is about 1.2 for E.ON.

As of 19 October 2007, the borrowing cost of a short position on E.ON is about 20bp. The only risk we see on the short is the dividend payment.

E.ON/RWE spread



Source: SG Cross Asset and Hedge Fund Research

Appendices

Analysis of notes to financial statements and SG restatements

From 2007, E.ON reports in accordance with IFRS, having previously reported under US GAAP. The impact on 2006 numbers, as provided by E.ON on 9 May 2007, is as follows:

- +€206m on EBIT (+2.5%) due principally to changes in the valuations of gas inventories.

- +€296m on adjusted net income (+6.7%).

- +€499m on reported net income (+8.9%) due to different treatment of non-operating net book gains, and different accounting of mark-to-market derivatives. The volatility of derivatives is greater under IFRS than under US GAAP, in our opinion. IAS39 has a different scope in comparison to US GAAP SFAS133, and there is also different treatment of derivatives embedded in other contracts.

- -€1.52bn on equity (-2.9%) largely due to the effects of IAS32, which reclassify conditional obligations to acquire shares held by minorities – for example the Statkraft option (shortly to be exercised), as well as investments in German partner shops, from minority interests to liabilities.

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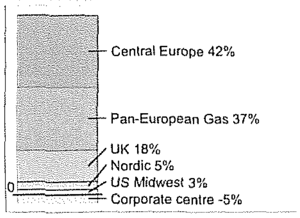
*Notice to UK Investors: All materials provided by SG Commodity Research, Quantitative Analysis and Technical analysis Research are produced in circumstances such that it is not appropriate to characterise it as impartial as referred to in the Financial Services Authority Handbook.

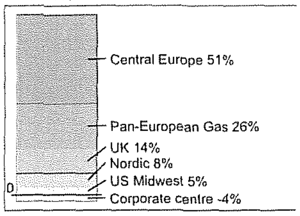
IMPORTANT DISCLOSURES

Capgemini	*Societe Generale and affiliates beneficially own 1% or more of any class of common equity of Capgemini*
Capgemini	*SG acted as co-lead manager in Capgemini's capital increase*
Distrigaz	*Societe Generale and affiliates beneficially own 1% or more of any class of common equity of Distrigaz*
Distrigaz	*SG is advisor to Gaz de France in its merger project with Suez*
E.ON	*Societe Generale and affiliates beneficially own 1% or more of any class of common equity of E ON*
EDF Energies Nouvelles	*SG acted as co-lead manager of EDF Energies Nouvelles' IPO*
ENEL	*SG makes a market in Enel warrants*
ENI	*Societe Generale and affiliates beneficially own 1% or more of any class of common equity of ENI*
ENI	*SG makes a market in Eni warrants*
Fluxys	*SG is advisor to Gaz de France in its merger project with Suez*
Gaz de France	*SG acted as sole advisor to Gaz de France in the disposal of Cofathec ADF*
Gaz de France	*Societe Generale and affiliates beneficially own 1% or more of any class of common equity of Gaz de France*
Gaz de France	*SG is advisor to Gaz de France in its merger project with Suez*
La Caixa (Caja de Ahorros y Pensiones de Barcelona)	*SG acted as Joint-lead manager in the La Caixa's (Caja de Ahorros y Pensiones de Barcelona) senior bond issue (4.625% 04/06/2019)*
MVV Energie AG	*SG is acting as Joint Bookrunner in MVV Energie AG's capital increase*
Suez	*Societe Generale and affiliates beneficially own 1% or more of any class of common equity of Suez*
Suez	*SG is advisor to Gaz de France in its merger project with Suez*

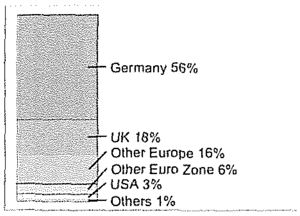
Sales/division 07



EBIT/division 07



Sales/region 07



Major shareholders (%)

Treasury stock	4.7

Normalised data

EBITDA margin (%)	19.5
Normalised growth (%)	2.6

Credit research*

NEGATIVE. Following Enel's succesfull bid on Endesa, E.ON has communicated its strategic initiatives for 2007-2010 to releverage the company in line with a mid-A credit through a €7bn sharebuyback and a €60bn capex plan which will raise the net debt/EBITDA ratio to 3.0x in 2008 vs. 1.5x in 2006. NEGATIVE(A2/A)

*Gay (33) 1 42 13 87 50

Assumes 8% share buyback in 2007-08 and inclusion of 2%, previously treasury stock, acquired by Statkraft

Assumes 60% future payout

Equity derivatives research*

3m realised volatility	24.2%
3m ATM implied volatility	25.9%
Exp. Stock risk/sector risk	1.14
Exp. Sector risk/Mkt risk	0.83
Exp. Stock risk/Mkt risk	0.95

*Joubert (33) 1 42 13 85 24

ADR Pr: $62.0	Target: $70.5		
(1 for 0.33 sh.)	06	07e	08e
P/E (x)	21.1	18.3	15.0
Yield (%)	2.2	2.8	3.6
P/CF (x)	9.5	8.1	8.3
€/$	1.26	1.33	1.42
Bloomberg			EONGY US

Electric Utilities (Germany) Price (19/10/07) 12m target

E.ON

BUY €131.3 €150.0

Valuation* (€m)	12/02	12/03	12/04	12/05	12/06	12/07e	12/08e	12/09e
Average nb of shares (diluted)	652.0	660.0	658.0	659.1	659.[illegible]	652.0	632.7	618.0
Share price (average)	52.81	43.31	57.94	73.14	93.19	131.25	131.25	131.25
Market capitalisation (average) (1)	36,713	30,005	40,129	50,609	64,522	83,975	81,113	81,113
Restated net debt (-)/cash (+) (2)	-35,421	-32,192	-27,553	-19,379	-16,903	-25,176	-41,714	-42,701
Value of minorities (3)	0	0	0	0	0	0	0	0
Value of financial investments (4)	0	0	0	0	0	0	0	0
Other adjustment (5)	0	0	0	0	0	0	0	0
EV = (1) - (2) + (3) - (4) + (5)	72,134	62,197	67,682	69,988	81,425	109,151	122,827	123,813
P/E (x)	12.4	7.2	9.9	12.3	13.1	16.6	14.1	12.3
Price/cash flow (x)	6.2	nm	1.7	5.2	5.4	7.1	7.6	7.1
Price/free cash flow (x)	77.7	9.6	11.4	nm	3.3	24.4	32.0	31.4
Price/book value (x)	1.4	1.0	1.1	1.[illegible]	1.3	1.8	1.8	1.6
EV/revenues (x)	1.94	1.34	1.38	1.24	1.27	1.58	1.51	1.46
EV/EBITDA (x)	9.4	6.6	6.4	6.8	6.9	8.7	8.3	7.8
Dividend yield (%)	3.3	4.6	4.1	3.8	3.6	3.1	3.8	4.6
Per share data (€)								
SG EPS (adj.)	4.26	5.98	5.88	5.93	7.10	7.89	9.29	10.66
Cash flow	8.53	-1.27	34.38	14.11	17.38	18.59	17.38	18.59
Book value	37.07	45.51	51.00	67.50	70.30	72.01	72.24	80.64
Dividend	1.75	2.00	2.35	2.75	3.35	4.10	5.00	6.00
Income statement (€m)								
Revenues	37,102	46,364	49,103	56,399	64,091	69,110	81,231	85,048
Gross income	9,357	9,761	11,392	11,052	11,789	13,110	15,267	16,383
EBITDA	7,680	9,458	10,520	10,257	11,789	12,570	14,727	15,843
Depreciation and amortisation	-2,948	-3,230	-3,159	-2,939	-3,433	-3,576	-4,227	-4,521
EBIT	4,732	6,228	7,361	7,318	8,356	8,994	10,501	11,322
Impairment losses	0	0	0	0	0	0	0	0
Net interest income	-1,377	-1,827	-1,220	-860	-668	-570	-1,380	-1,460
Exceptional & non-operating items	1,078	0	589	3,526	0	0	0	0
Taxation	645	-1,124	-1,947	-2,276	323	-2,810	-3,145	-3,181
Minority interests	-637	-464	-504	-553	-526	-579	-229	-245
Reported net income	1,949	3,969	4,357	7,392	5,307	5,392	6,125	6,837
SG adjusted net income	2,777	3,950	3,867	3,910	4,682	5,142	5,875	6,587
Cash flow statement (€m)								
EBITDA	7,680	9,458	10,520	10,257	11,789	12,570	14,727	15,843
Change in working capital	0	-250	87	-4,830	7,504	366	1,142	628
Other operating cash movements	-3,990	-3,575	-4,548	-6,261	3,362	-3,735	-4,875	-4,985
Cash flow from operating activities	3,690	5,683	6,059	-835	22,656	9,201	10,994	11,486
Net capital expenditure	-3,247	-2,660	-2,712	-2,990	-4,083	-5,700	-8,400	-8,900
Free cash flow	443	2,973	3,347	-3,825	18,573	3,501	2,594	2,586
Cash flow from investing activities	-9,983	4,164	-38	4,606	-3,113	-500	-10,500	0
Cash flow from financing activities	-1,100	-1,142	-1,312	-1,562	-4,703	-4,710	-7,123	-3,090
Net change in cash resulting from CF	-10,640	5,995	1,997	-781	10,757	-1,709	-15,029	-504
Balance sheet (€m)								
Total long-term assets	78,000	78,630	79,068	82,211	96,334	103,167	116,907	121,979
of which intangible	5,391	4,114	3,788	3,839	3,749	4,390	5,964	6,084
Working capital	19,463	15,080	11,862	16,537	1,355	1,857	4,365	4,867
Employee benefit obligations	0	0	0	0	0	0	0	0
Shareholders' equity	25,653	29,774	33,560	44,484	46,328	46,949	45,705	49,834
Minority interests	6,511	4,625	4,144	4,734	4,917	2,700	1,755	1,799
Provisions	34,309	34,206	34,242	33,862	31,977	31,862	32,033	32,207
Net debt (-)/cash (+)	-13,979	-10,992	-5,483	2,703	137	-8,326	-24,768	-25,656
Accounting ratios								
ROIC (%)	4.2	5.2	6.4	6.3	7.8	8.9	9.2	8.9
ROE (%)	7.8	14.3	13.8	18.9	11.7	11.6	13.2	14.3
Gross income/revenues (%)	25.2	21.1	23.2	19.6	18.4	19.0	18.8	19.3
EBITDA margin (%)	20.7	20.4	21.4	18.2	18.4	18.2	18.1	18.6
EBIT margin (%)	12.8	13.4	15.0	13.0	13.0	13.0	12.9	13.3
Revenue yoy growth (%)	-0.5	25.0	5.9	14.9	13.6	7.8	17.5	4.7
Rev. organic growth (%)	1.0	1.0	1.5	1.5	1.5	1.0	1.0	1.0
EBITDA yoy growth (%)	15.5	23.2	11.2	-2.5	14.9	6.6	17.2	7.6
EBIT yoy growth (%)	28.1	31.6	18.2	-0.6	14.2	7.6	16.8	7.8
EPS (adj.) yoy growth (%)	8.9	40.5	-1.8	0.9	19.7	11.0	17.7	14.8
Dividend growth (%)	9.4	14.3	17.5	17.0	21.8	22.4	22.0	20.0
Cash conversion (%)	-4.3	65.8	71.9	-21.2	218.4	70.2	54.7	50.9
Net debt/equity (%)	43.5	32.0	14.5	nm	nm	16.8	52.2	49.7
FFO/net debt (%)	19.6	20.2	26.7	36.7	67.7	36.5	24.5	26.2
Dividend paid/FCF (%)	248.3	38.4	39.2	nm	25.3	63.1	101.1	119.5

*** Valuation ratios for past years are based on average historical prices and market capitalisations**

Europe: Utilities: Power

Exploring the coal-power connection; raising price assumptions and price targets

We raise our German power forecasts to reflect higher coal prices

We are raising our forecasts for coal to reflect GS Commodity Research's estimates in the short term as well as to approximate the forward curve in the medium term. As coal is the main marginal plant in Germany, we are raising our forecasts for German forwards to €65/MWh for 2008 and €60/MWh in the medium term. We have raised our forecasts for Nordic prices to €57/MWh for 2009 and €55/MWh in the medium term.

Increased EPS and valuation for stocks geared to Central European power prices

Utilities affected by the German power price are RWE, E.ON, EDF, CEZ, Fortum, Verbund and Suez. For these stocks, our EPS forecasts have increased by an average 3%-8% p.a. over the next five years. The average forecast CAGR over 2006-10 for these stocks is 16%, representing a premium to the sector average of 12% over the same period. We have raised price targets by 7%-14% with those of CEZ and Verbund increasing the most.

German clean dark spreads have fallen by more than 50%

2008 coal prices are up 70% since January whereas the 2008 German power price has only risen by 13%. This has led to a reduction by more than 50% in the forward clean dark spreads. Our new forecasts represent a marginal improvement to the spread; however, we believe the expectations built into share prices reflect even higher scenarios.

Our forecasts/valuations appear more cautious than the market

We believe the shares geared to the German power price reflect either c. €65/MWh medium term or short-term prices to spike materially above €70/MWh. We are more cautious: in the short term, we believe there is a risk of an increase in reserve margins; medium term, we reflect the steep reduction in the coal curve in our forecast of €60/MWh. We remain Neutral on RWE, Verbund, CEZ and Fortum and reiterate our Buy ratings on E.ON and EDF, which we believe offer more potential valuation upside and lower risk to any disappointment on power pricing.

ACTION

Price target changes

	Rating	New price target	Old price target	% change	versus share price
EdF	Buy	€92	€82	12%	9%
E.ON	Buy	€144	€134	7%	6%
Fortum	Neutral	€29	€26	12%	-5%
Verbund	Neutral	€42	€37.5	13%	-6%
CEZ	Neutral	Kc1,250	Kc1,100	14%	-9%
RWE	Neutral	€80	€74	8%	-17%
Suez	NR	n/a	n/a		

All price targets have a 12-month time frame.

Source: Goldman Sachs Research estimates.

Coverage view: Neutral

Goldman Sachs is acting as financial advisor to Gaz de France in an announced strategic transaction.

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Overview: Higher coal should lead to higher German and Nordic power prices

As a result of higher coal forecasts, *we are raising our forecasts for German power*

We are raising our forecasts for coal prices to reflect GS Commodities Research's assumptions in the short term and to approximate the forward curve in the medium term. We move to $110/t delivered (API2) coal in 2008, $100/t in 2009 and $90/t thereafter. As coal is the marginal plant in Germany most of the time, we are raising our forecast for German power to €65/MWh in 2008 and €62.5/MWh in 2009 and to €60/MWh thereafter.

Higher power price forecasts drives earnings and valuation upgrades

Stocks geared to German/Central European power prices are: RWE, E.ON, Fortum, Verbund, CEZ, Suez and EDF. For these stocks, we have increased forecasts on average by 3%-8% p.a. *through to 2011 and most price targets increase* by 7-14%. Based on our revised forecasts, the average CAGR over 2006-10 for these stocks is 16%, representing a premium to the sector as a whole, which offers 12% over the same period. The most significant short-term earnings upgrades based on higher power prices are for Fortum, Verbund, RWE and Suez. We have upgraded our price targets by 7-14% across the sector with the most significant upgrades for EDF, Verbund, Fortum and CEZ.

Exhibit 1: We have upgraded our price targets by between 6-14%, we maintain our ratings

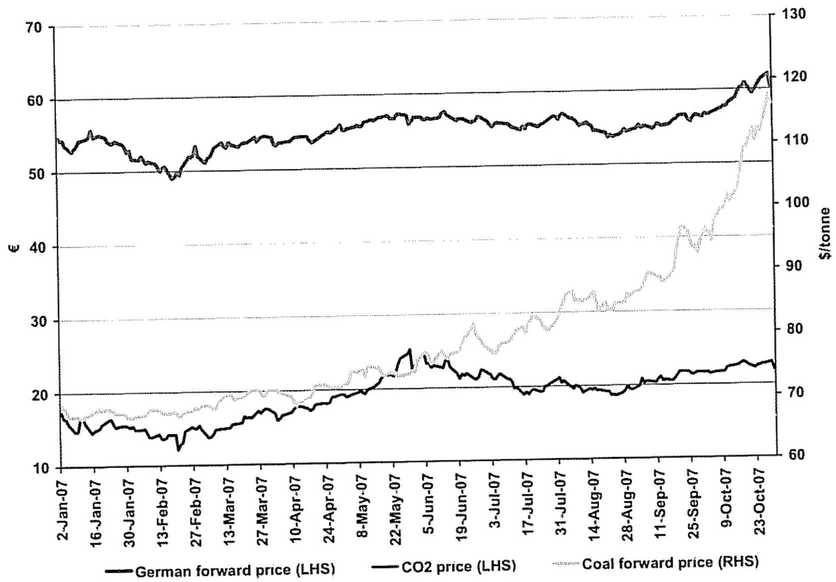
Share	Rating	Share price	Previous price target	New price target	Increase in target price	Upside/ downside to target price	Price Target Time Frame
EDF	BUY	85	82	92	12%	9%	12 months
E.ON	BUY	136	134	144	7%	6%	12 months
Fortum	Neutral	31	26	29	12%	-5%	12 months
Verbund	Neutral	45	37.5	42	13%	-6%	12 months
CEZ	Neutral	1,367	1,100	1,250	14%	-9%	12 months
RWE	Neutral	96	74	80	8%	-17%	12 months

Source: Datastream, Goldman Sachs Research estimates.

Higher coal prices should lead to higher power forwards

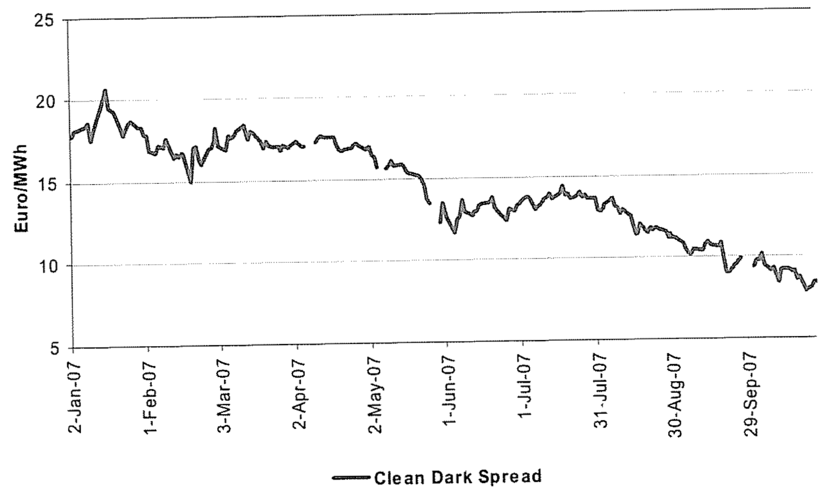
As coal is the marginal plant in Germany, higher forward coal prices should lead to higher German power prices. Although coal forwards are up 70% since January, German power forwards have only increased by 13% (Exhibit 2). This has led to an over 50% reduction of the clean dark spreads in Germany (Exhibit 3). Our new forecasts represent a marginal improvement to the spread, however we think the expectations *built into the share prices reflect even higher scenarios.*

Exhibit 2: Coal is up 70% since January vs. German power prices up 13%
Correlation high between coal forward prices and German power prices since August



Source: Heren, Bloombert

Exhibit 3: Clean dark spreads have collapsed over the past year
Clean dark spreads have fallen from above €18/MWh to less than €8/MWh



Source: Goldman Sachs Research estimates, Bloomberg, Platts.

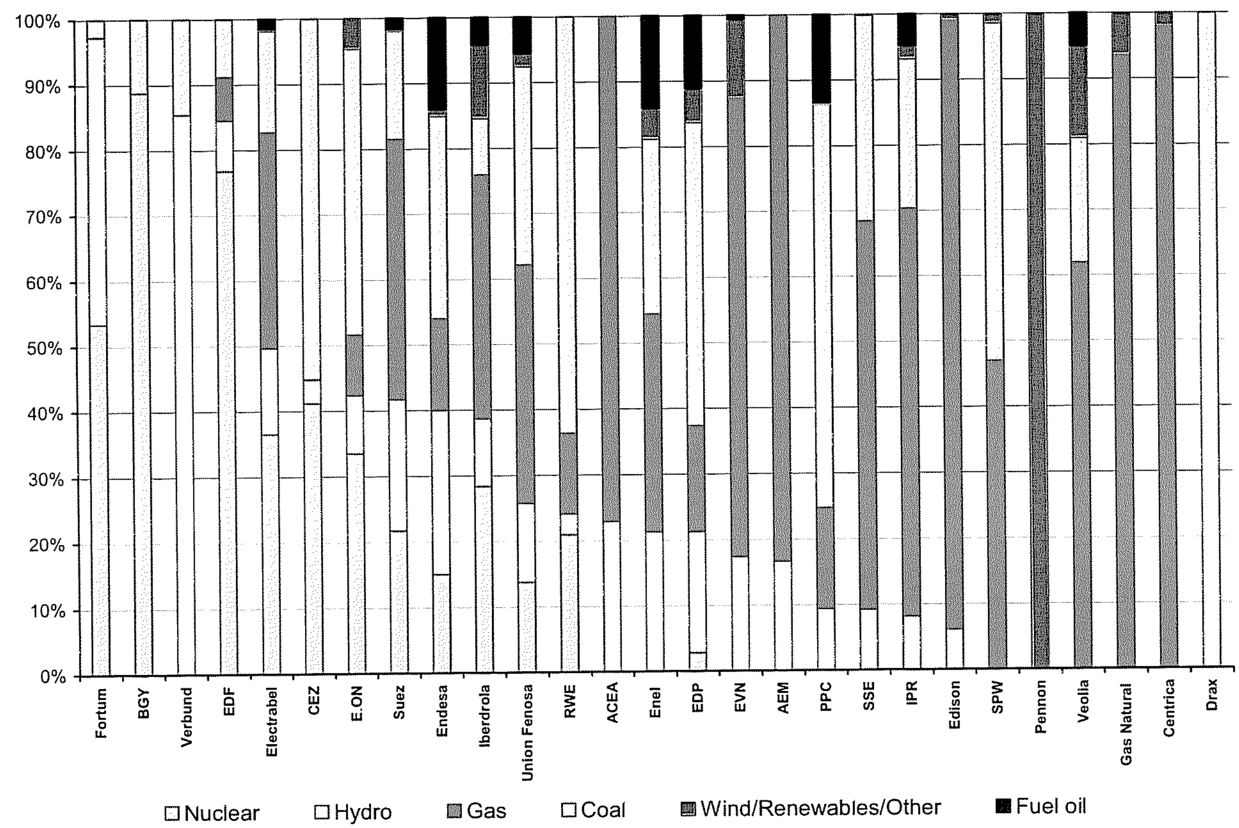
We are more cautious on the outlook for the German power price than what is reflected in the stocks

We believe the shares geared to the German power price are reflecting either c. €65/MWh medium-term or short-term prices to spike materially above €70/MWh. We are more cautious: in the short term, we believe there is a risk of an increase in reserve margins; medium term, we reflect the steep reduction in the coal curve in our forecast of €60/MWh for German power.

Revised company forecasts: Forecasts upgraded by 3-8% on average over 2007-11

Higher coal costs are positive for the profits of utilities geared to the German power price as higher marginal fuel costs lead to higher power prices for all plants including hydro, nuclear and lignite, the costs of which will not be affected. As all of the stocks geared to the German/Central European power price have a mix in capacity (Exhibit 4), their generation margins should increase with higher marginal pricing.

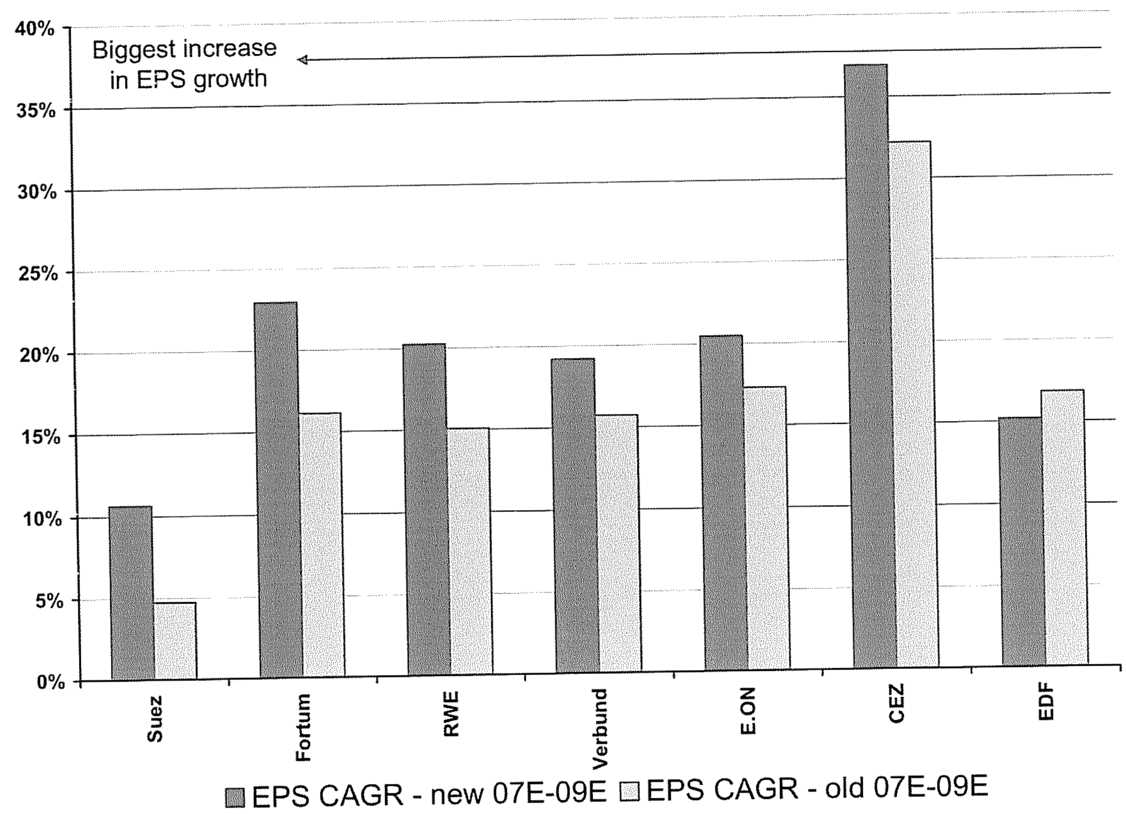
Exhibit 4: Fuel mix across the European Utilities
Fortum, Verbund and EDF produce the majority of their power from nuclear and hydro. Of its coal, CEZ has a much higher proportion of lignite (85%) than RWE (59%).



Source: Company data, Goldman Sachs Research estimates.

The actual power price achieved by a utility often lags the forward market owing to hedging policies. For the stocks geared to the German power price, we have increased our forecasts on average by 3%-8% p.a. through to 2011 and most of our price targets by 7%-14%. Based on our revised forecasts, the average CAGR of these stocks over 2006-10 is 16%, representing a premium to the average of 12% over the same period. The increase in our forecast CAGR over 2007-09 is the greatest for Suez, Fortum, RWE and Verbund as set out in Exhibit 5.

Exhibit 5: Utilities ranked in order of change in EPS CAGR to 2009E
EPS CAGR increases 2007E-09E greatest for Suez, Fortum, RWE and Verbund, with CEZ offering the greatest earnings growth over the period.



Source: Goldman Sachs Research estimates.

Earnings impact varies from year to year but our EPS estimates increase by 3-8% over 2006-11

Exhibit 6: EPS forecasts up 3%-8% p.a. on average over 2006-11 for the affected stocks

Sector earnings estimate changes (€ mn / € per share)	old 2008E	new 2008E	% change	old 2009E	new 2009E	% change	old 2010E	new 2010E	% change	old 2011E	new 2011E	% change
E.ON												
EBITDA	13,499	13,576	1%	14,572	15,056	3%	15,471	15,984	3%	16,280	16,612	2%
Net Income	6,235	6,303	1%	6,558	6,928	6%	7,003	7,417	6%	7,417	7,725	4%
EPS	10.14	10.25	1%	10.92	11.54	6%	11.67	12.36	6%	12.36	12.87	4%
RWE												
EBITDA	8,533	8,532	0%	8,989	9,532	6%	9,303	9,864	6%	9,433	9,853	4%
Net Income	3,814	3,812	0%	4,178	4,560	9%	4,294	4,700	9%	4,298	4,620	7%
EPS	6.78	6.78	0%	7.43	8.11	9%	7.64	8.36	9%	7.64	8.21	7%
Fortum												
EBITDA	2,533	2,588	2%	2,986	2,986	0%	2,892	3,173	10%	2,988	3,182	7%
Net Income	1,479	1,520	3%	1,629	1,825	12%	1,762	1,977	12%	1,838	1,991	8%
EPS	1.66	1.70	3%	1.82	2.04	12%	1.97	2.21	12%	2.06	2.23	8%
Verbund												
EBITDA	1,327	1,384	4%	1,437	1,514	5%	1,472	1,573	7%	1,502	1,537	2%
Net Income	698	733	5%	773	820	6%	802	866	8%	830	857	3%
EPS	2.26	2.38	5%	2.51	2.66	6%	2.60	2.81	8%	2.69	2.78	3%
Suez												
EBITDA	7,847	8,110	3%	8,516	9,132	7%	9,868	10,558	7%	11,168	11,488	3%
Net Income	3,233	3,405	5%	3,506	3,915	12%	4,261	4,736	11%	5,069	5,319	5%
EPS	2.53	2.67	5%	2.73	3.05	12%	3.30	3.67	11%	3.91	4.10	5%
EDF												
EBITDA	16,387	16,293	-1%	18,154	17,884	-1%	19,168	19,152	0%	19,984	20,419	2%
Net Income	5,967	5,897	-1%	7,069	6,873	-3%	7,668	7,643	0%	8,159	8,444	3%
EPS	3.27	3.24	-1%	3.88	3.77	-3%	4.21	4.19	0%	4.48	4.63	3%
CEZ *(CZK mn)*												
EBITDA	89,626	92,931	4%	102,645	107,696	5%	97,755	104,637	7%	98,476	107,243	9%
Net Income	47,481	50,152	5.6%	58,662	62,918	7.3%	55,768	61,741	11%	56,171	63,865	14%
EPS	87.2	92.1	5.6%	110.1	118.0	7.3%	104.6	115.8	11%	105.4	119.8	14%

Source: Goldman Sachs Research estimates.

Achieved power price assumptions by companies

Exhibit 7 highlights our average achieved power price forecasts for the utilities geared to the German power market. These will differ relative to our power price assumptions owing to hedging policies as well where the plant lies on the merit order, base- or peak-load plant. As set out in the table, Verbund's achieved prices are at a premium to reflect its high proportion of peak load plant.

Exhibit 7: European utilities achieved power price assumptions. The lag reflects assumptions on hedging.

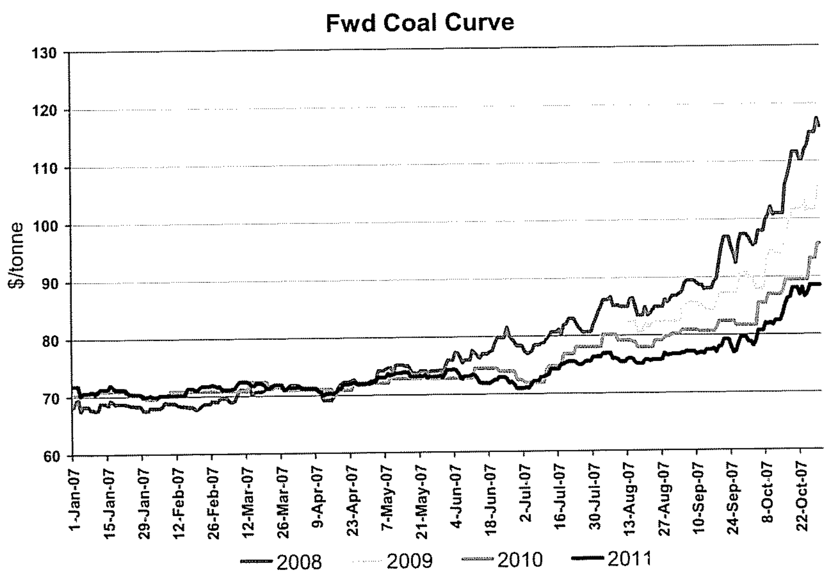
€/MWh	2006	2007E	2008E	2009E	2010E	2011E
Central Europe						
E.ON (new)	**38.0**	**45.0**	**53.4**	**62.1**	**62.8**	**60.3**
E.ON (old)	38.0	45.0	52.1	57.7	59.0	57.3
Change compared to previous forecast	*0%*	*0%*	*2%*	*8%*	*6%*	*5%*
RWE (new)	**38.0**	**45.0**	**53.9**	**62.4**	**62.6**	**60.3**
RWE (old)	38.0	45.0	52.7	57.5	59.1	57.5
Change compared to previous forecast	*0%*	*0%*	*2%*	*9%*	*6%*	*5%*
EDF (new)	**35.4**	**34.8**	**37.0**	**42.7**	**44.2**	**47.0**
EDF (old)	35.4	34.8	36.6	39.0	41.3	43.7
Change compared to previous forecast	*0%*	*0%*	*1%*	*9%*	*7%*	*7%*
SUEZ (new)	**42.8**	**44.5**	**52.5**	**57.8**	**59.8**	**59.0**
SUEZ (old)	42.8	44.5	50.3	53.8	56.0	56.9
Change compared to previous forecast	*0%*	*0%*	*4%*	*7%*	*7%*	*4%*
CEZ (new)	**39.2**	**47.6**	**58.0**	**65.0**	**62.0**	**62.0**
CEZ (old)	39.2	47.6	56.0	62.0	58.0	57.0
Change compared to previous forecast	*0%*	*0%*	*4%*	*5%*	*7%*	*9%*
Verbund (new)	**47.0**	**51.6**	**63.1**	**68.3**	**67.9**	**64.8**
Verbund (old)	47.0	51.6	60.1	63.8	63.2	63.0
Change compared to previous forecast	*0%*	*0%*	*5%*	*7%*	*7%*	*3%*
Nordic						
Fortum (new)	**37.1**	**39.8**	**47.9**	**54.5**	**56.5**	**54.5**
Fortum (old)	37.1	39.8	46.8	49.8	51.6	51.3
Change compared to previous forecast	*0%*	*0%*	*2%*	*9%*	*9%*	*6%*
Italy						
Enel	76.8	78.3	80.2	79.6	74.2	72.5
AEM (excluding Edipower and Edison)	84.6	77.0	85.5	88.5	81.8	79.9
Iberia						
Endesa		55.0	62.0	64.0	62.0	62.0
Iberdrola		52.0	65.0	67.0	65.5	66.0
Union Fenosa		50.0	62.0	64.0	62.0	62.0
UK						
£/MWh						
British Energy	44.2	39.6	44.5	42.7	41.8	42.6
Drax	48.9	44.3	46.8	44.3	44.8	44.6

Source: Company data, Goldman Sachs Research estimates.

Our upgrade to coal and power forecasts

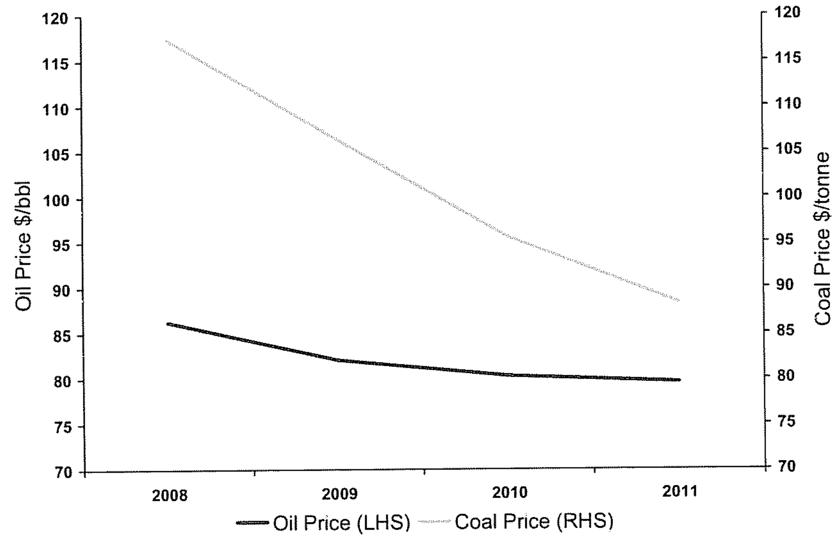
The 2008 contract coal prices have increased by 70% since earlier this year reflecting an increase in shipping costs as well as higher (FOB) prices for thermal coal. 2010-11 forward prices for coal have also increased materially by 25%-35% reflecting higher thermal coal prices as shipping costs fall in the forward market. Unlike the forward oil curve, the coal curve has a much steeper reduction over the next few years, primarily reflecting the reduction in shipping costs.

Exhibit 8: Short and medium term forward coal curve has moved up
2008 coal forward is up 70% vs. the 2011 coal forward which is up 25%



Source: Bloomberg.

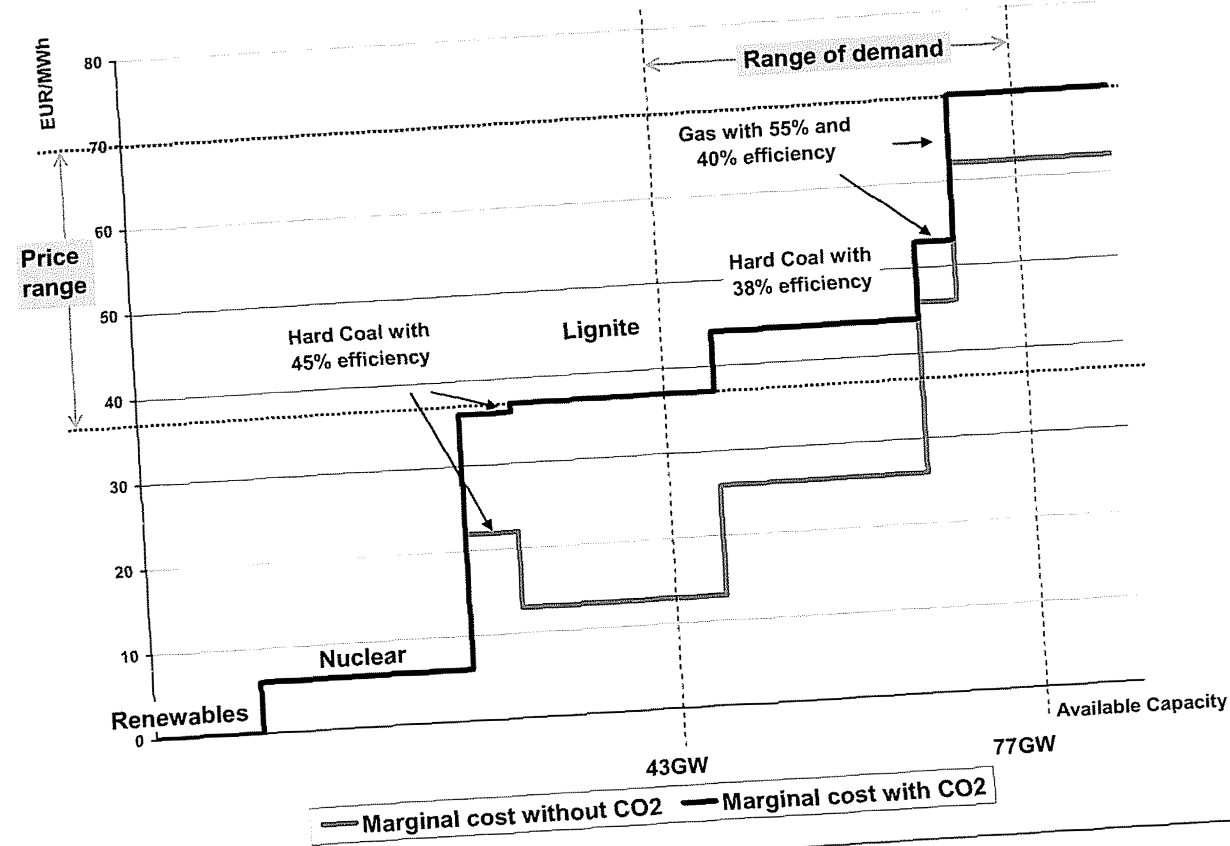
Exhibit 9: Coal forward curve has a much steeper correction vs. oil
Coal forward prices imply a 25% reduction over 2008-11 vs. oil forwards which fall by 6%



Source: Goldman Sachs Research estimates, Bloomberg, Platts.

We have upgraded our coal forecasts to reflect GS Commodities Research's coal forecasts plus the current market forwards for shipping for the next three years. Beyond this, we have used the market forward price for coal of $90/t, so as to reflect the steep reduction in the forward prices. As coal is the main marginal plant in Germany, higher coal forecasts has led to higher power price forecasts for Germany (Exhibit 10).

Exhibit 10: German Merit Order
Hard coal is the main marginal plant in Germany



Source: Company data, Goldman Sachs Research estimates.

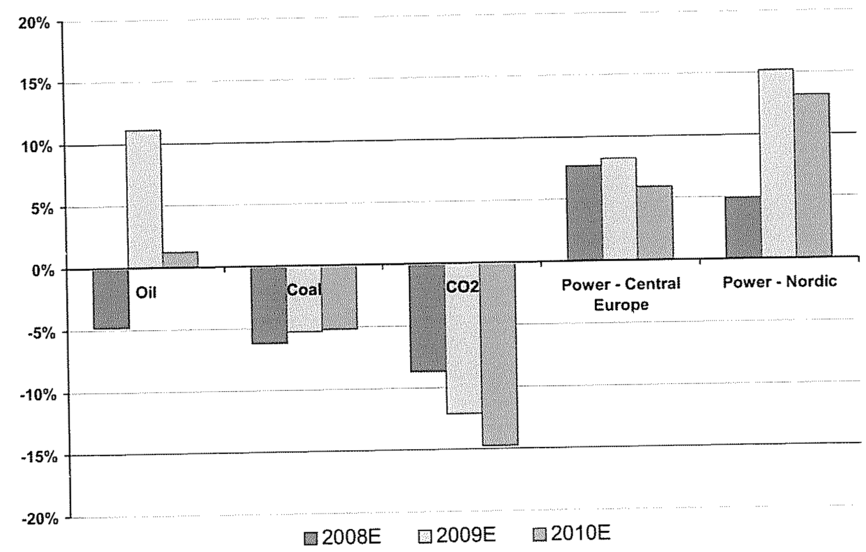
Our revised forecasts are broadly in line with the forward curve for coal but higher vs. forward power curve (Exhibit 12). Based on our new entrant calculations, and using forward coal markets, we estimate the long run marginal cost of new entrant to be €60/MWh (Exhibit 15). Our new assumptions for power prices bring our medium-term prices for Germany/Central Europe in line with the gas driven power markets such as the UK and Southern Europe (Exhibit 11).

Exhibit 11: Increases in coal price forecasts lead to increases in German/Central European power prices

		2008E	2009E	2010E	2011E	2012E +
GSf Oil	US$/bbl	80	90	80	75	60
Oil (forward market)	US$/bbl	84	81	79	79	
GSf Coal (new)	**US$/t**	**110**	**100**	**90**	**90**	**90**
Change comparred to previous forecast		*29%*	*18%*	*13%*	*17%*	*29%*
Coal (forward market)	US$/t	117	106	95	89	
GSf CO2	€/t	20	20	20	20	20
CO2 (forward market)	€/t	22	23	23	23	24
Power price assumptions						
GSf German Power (new)	**€/MWh**	**65.0**	**62.5**	**60.0**	**60.0**	**60.0**
Change comparred to previous forecast		*10%*	*4%*	*7%*	*9%*	*9%*
German base (forward market)	€/MWh	60	58	57	57	57
GSf Nordic (new)	**€/MWh**	**54**	**57**	**56**	**55**	**55**
Change comparred to previous forecast		*10%*	*10%*	*10%*	*9%*	*9%*
Nordic (forward market)	€/MWh	51	50	50	49	49
GSf Italy	€/MWh	70	74	70	69	63
GSf Iberia	€/MWh	60	62	60	60	59
GSf UK Power	€/MWh	64	69	64	62	59
GSf UK Power	£/MWh	46	49	46	44	42

Source: Goldman Sachs Research estimates. Nordpool. EEX, Reuters, Platts, Bloomberg.

Exhibit 12: We are calling power prices up in Germany and the Nordic area
Our commodity assumptions vs. current commodity price forecast



Source: Goldman Sachs Research estimates. Bloomberg, Platts. Reuters, Heren

We continue to expect the Nordic market to trade at a discount owing to demand swings and the hydro/nuclear base. We forecast the discount to fall from that implied by today's forward markets but do not expect full convergence over the next few years owing to limited interconnection capacity increases.

Valuation sensitivities based on different scenarios for energy commodities

We have analyzed the valuation sensitivity to different energy commodity price and capacity price scenarios. We believe the shares geared to the German power price are reflecting either c. €65/MWh medium-term or short-term prices to spike materially above €70/MWh. We are more cautious: in the short term, we believe there is a risk of an increase in reserve margins; medium term, we reflect the steep reduction in the coal curve in our forecast of €60/MWh for German power.

Exhibit 13: The impact of different scenarios on valuations
We vary coal, carbon and capacity costs

Scenario Assumptions

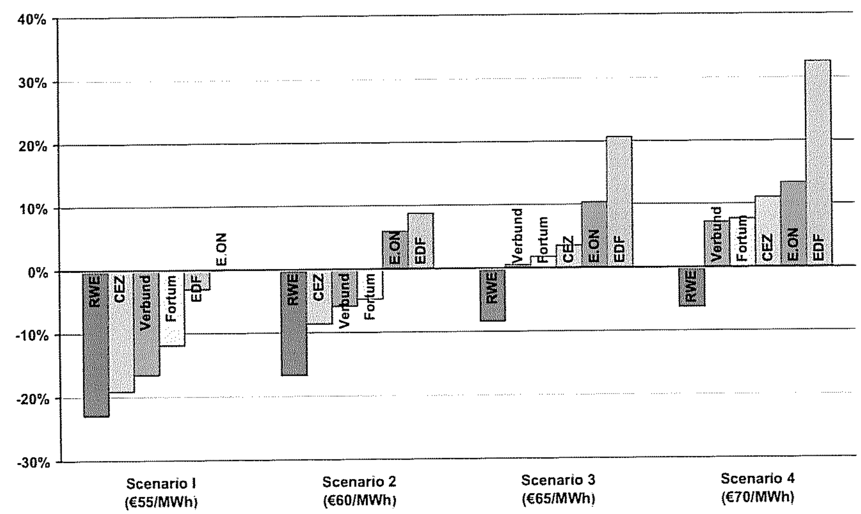
		Scenario I old assumptions	Scenario 2 new assumptions	Scenario 3	Scenario 4
Base Power	€/MWh	55	60	65	70
Coal	$/t	70	90	110	110
Carbon	€/t	20	20	20	25
Capital costs	€/GW	1,100	1,200	1,200	1,400
EON	per share	136	144	150	154
RWE	per share	74	80	88	90
Verbund	per share	38	42	45	48
Fortum	per share	27	29	31	33
EdF	per share	82	92	102	112
CEZ	per share	1,106	1,250	1,417	1,519

% value growth in different scenarion

	Scenario 2	Scenario 3	Scenario 4
EON	6%	10%	13%
RWE	8%	19%	22%
Verbund	13%	21%	29%
Fortum	8%	16%	22%
EdF	12%	24%	37%
CEZ	13%	28%	37%

Source: Goldman Sachs Research estimates.

Exhibit 14: We believe some stocks are reflecting €65/MWh medium term
Valuations based on different scenarios vs. current share prices



Source: Goldman Sachs Research estimates, Bloomberg, Platts.

Assuming the market is basing its valuation on the same German market power price across the affected stocks, we consider below why stocks would trade at a premium/discount to our target valuations. We believe the market may be:

- Valuing short-term earnings growth more highly than medium-term earnings reductions, which may explain some of the premium at RWE and CEZ both of which have significant carbon liabilities. In line with our assumptions for full auctioning from 2013, we expect earnings to fall by 30% at RWE and 20% at CEZ in 2013. To justify RWE's current share price vs. Scenario 3 (€65/MWh), one would need to assume 20% free carbon forever. The EU has said it will set out guidelines for Phase III carbon trading on January 23, 2008. We expect the EU to call for full auctioning for all generators.

- Valuing short-term earnings growth more highly than medium term earnings growth, which may explain some of the discount for EDF and premiums for the others. The majority of EDF's sales are capped by French tariffs through 2011 although costs such as coal and carbon are not.
- Take a more optimistic/pessimistic view on French tariff convergence than we do. We assume EDF's achieved generation prices converge fully with those in Europe by 2015, based on €60/MWh, this implies an annual tariff increase of 5% over 2011-15. (This was 4.1% under the previous scenario of €55/MWh medium term).
- Take a different view on the pace of convergence of the Nordic prices and the German prices. According to forward power markets, discounts of 16% are expected. We expect this to fall to 10% medium term due to some marginal increases in interconnector capacity planned.
- Assume greater differentical between peak and base prices, which is material for Verbund's valuation as it has the highest proportion of peaking capacity among those stocks geared to the German price.
- A more conservative view than even ours with regard to E.ON's ability to create value with its growth capex program. (Our E.ON valuation is based on no material value creation besides the balance sheet improvements and only factor in €10 bn of additional regearing in our 12-month price target.

Exhibit 15: New entrant calculations based on different assumptions for coal and capital costs

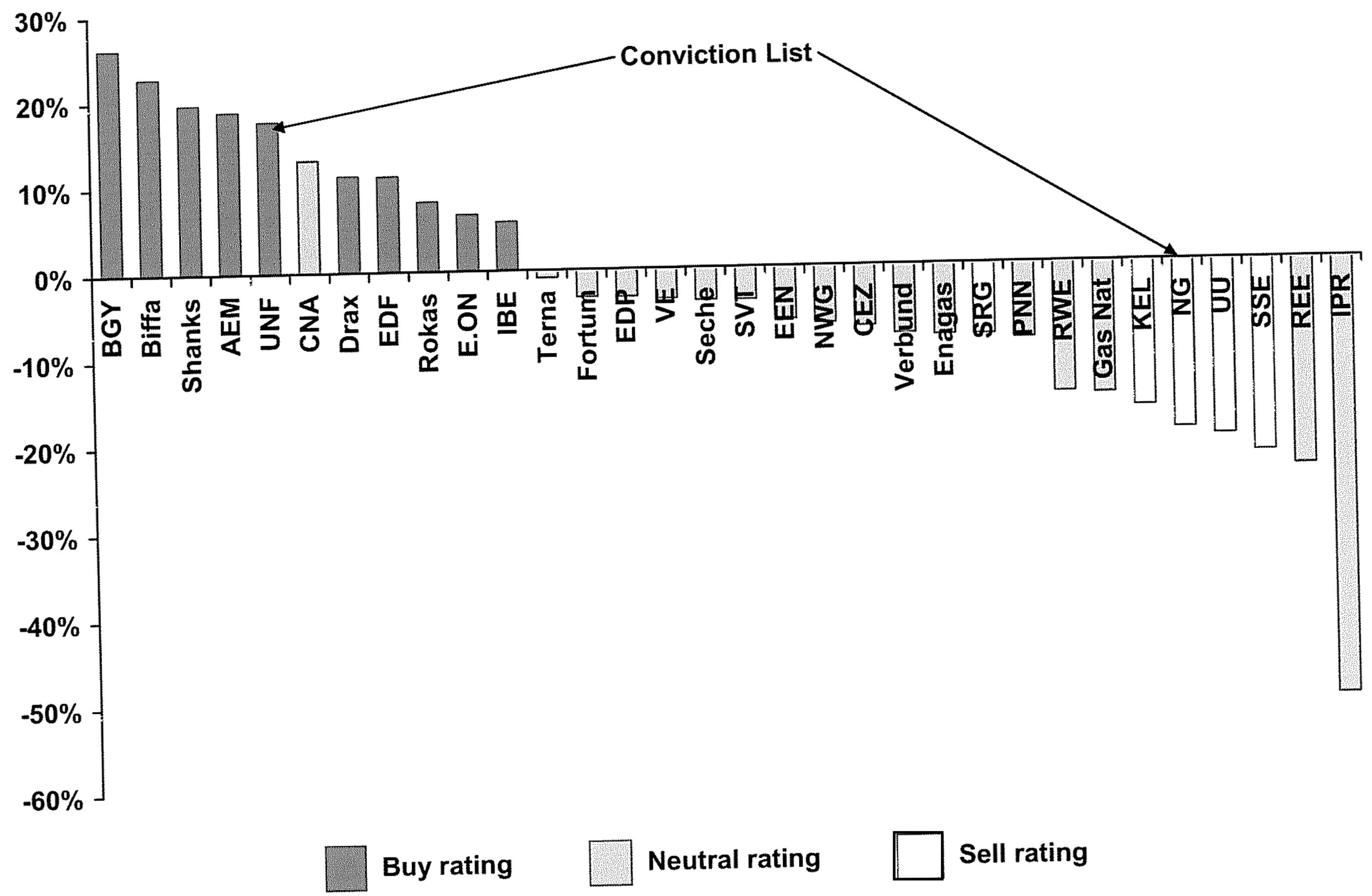
Thermal efficiency assumed		45%	45%	45%	45%
Coal costs (CIF ARA)	EUR per ton	70	90	110	110
Exchange rate	EUR per ton	1.41	1.35	1.35	1.35
Coal costs (CIF ARA)	EUR per ton	50	67	81	81
Gas cost (BAFA)	EUR per MWh				
Transport to plant	EUR per ton (Coal)/ EUR per MWh (Gas)	5	5	5	5
Fuel cost at plant doors	EUR per ton (Coal)/ EUR per MWh (Gas)	54	71	86	86
Calorific Content of coal		6,000	6,000	6,000	6,000
Conversion Ratio		6,978	6,978	6,978	6,978
Fuel cost at plant doors	EUR per Mwh	7.8	10.2	12.3	12.3
Thermal efficiency assumed		45%	45%	45%	45%
Pure fuel variable cost	**EUR per MWh**	**17**	**23**	**27**	**27**
Other variable cost	EUR per MWh	0.7	0.7	0.7	0.7
Fixed costs	EUR mn per year	30	30	30	30
Depreciation life (accounting life)	years	25	25	25	25
Plant life	years	35	35	35	35
Construction costs (for 1,000MW)	**EUR mn**	**1,200**	**1,200**	**1,200**	**1,350**
Financing: Debt		60%	60%	60%	60%
Debt	EUR mn	**720**	**720**	**720**	**810**
Financing: Equity		40%	40%	40%	40%
Equity	EUR mn	**480**	**480**	**480**	**540**
WACC		6.0%	6.0%	6.0%	6.0%
New entrant cost at 90% load factor	EUR per MWh	36	41	46	48
New entrant cost at 80% load factor	EUR per MWh	38	43	48	50
New entrant cost at 70% load factor	**EUR per MWh**	**41**	**46**	**51**	**53**
New entrant cost at 60% load factor	**EUR per MWh**	**45**	**50**	**55**	**57**
New entrant cost at 50% load factor	EUR per MWh	50	55	60	63
CO2 emissions	tons per MWh	0.70	0.70	0.70	0.70
Assumed long term Co2 costs	EUR per ton	20	20	20	25
Additional operating costs	**EUR per MWh**	**14**	**14**	**14**	**18**
New entrant (70% load) plus CO2	EUR per MWh	**54.8**	**60.2**	**64.9**	**70.7**

Source: Goldman Sachs Research estimates.

One of the key uncertainties over the medium term is the inflation in capacity costs. Generators are reporting significant rises in costs from the equipment manufacturers. The assumptions in our base case are using recent estimates provided by the companies. (E.ON recently set out a range of €40-60/MWh for long-term new entry costs for coal including carbon.) In Scenario 4, we have also looked at the impact of higher capital costs on power prices (Exhibit 15).

We continue to see the most upside of those stocks geared to the German price in EON and EDF, both BUY

Exhibit 16: Share price upside/(downside) to revised price targets – we remain buyers of E.ON and EDF
Conviction Buy: Union Fenosa; Conviction Sell: National Grid



Source: Goldman Sachs Research estimates.

Exhibit 17: European Utilities Valuation Tables

Priced as of close of November 31, 2007

Stock	Rating	Price Target [12 months]*	Share Price [3] 31/10/2007	No. of Shares (mn)	Mkt Cap (mn) [5]	Free float (%)	Year End [1]	P/E (EBG) [2] 2006	P/E 2007E	P/E 2008E	P/E 2009E	EV/EBITDA 2006	EV/EBITDA 2007E	EV/EBITDA 2008E	EV/EBITDA 2009E	FCF Yield 2006[9]	FCF Yield 2007E[9]	FCF Yield 2008E	FCF Yield 2009E	Net Dividend Yield 2006	Net Dividend Yield 2007E	Net Dividend Yield 2008E	Net Dividend Yield 2009E
EUROPE [EUR]																							
EDF [8]	Buy	92.0	82.79	1,822	150,858	13%	Dec	26.8	28.5	25.1	21.6	12.9	11.8	10.9	9.8	2%	1%	0%	1%	1.5%	1.6%	1.8%	2.1%
Suez	NR		44.90	1,276	57,280	100%	Dec	15.1	18.0	16.8	14.7	9.3	10.2	9.4	8.6	11%	2%	1%	1%	3.7%	3.0%	3.2%	3.5%
Veolia Environnement	Neutral	59.5	61.65	393	24,278	59%	Dec	23.7	20.5	17.4	14.7	10.7	9.9	8.6	7.9	(2%)	(11%)	(7%)	(4%)	1.7%	2.0%	2.6%	3.2%
Séche Environnement	Neutral	122.0	126.70	9	1,069	36%	Dec	20.7	26.8	21.5	18.4	8.2	11.0	9.5	8.6	4%	(22%)	3%	3%	1.5%	1.2%	1.5%	1.8%
E.ON [6]	Buy	144	135.1	659	93,462	87%	Dec	20.3	17.0	13.2	11.7	8.9	8.3	7.4	7.4	6%	2%	(14%)	(2%)	2.5%	3.0%	3.6%	3.8%
RWE [6]	Neutral	80.0	94.10	558	52,510	54%	Dec	21.5	16.8	13.9	11.6	10.3	8.6	8.4	7.4	30%	2%	15%	2%	3.7%	4.0%	3.5%	3.6%
Verbund	Neutral	42.0	45.61	308	14,057	22%	Dec	28.7	24.4	19.2	17.1	15.6	13.2	10.2	9.3	2%	(0%)	2%	3%	1.6%	1.9%	2.2%	2.5%
Fortum	Neutral	29.0	29.93	887	17,857	48%	Dec	25.0	22.1	17.6	14.6	10.6	12.6	10.4	8.8	0%	5%	5%	6%	2.4%	2.7%	3.4%	4.1%
AEM	Buy	3.45	2.91	1,800	5,229	57%	Dec	21.0	20.8	17.9	17.3	9.6	9.1	8.3	7.8	11%	(1%)	8%	11%	2.4%	2.8%	3.1%	3.4%
Enel [6]	NR		8.27	6,176	51,102	67%	Dec	16.8	13.5	10.8	10.6	9.1	9.8	8.4	7.6	10%	(55%)	23%	7%	5.9%	6.4%	6.7%	6.7%
Snam RG [6]	Sell	4.10	4.47	1,761	7,862	50%	Dec	18.8	17.2	16.3	15.9	9.7	9.3	9.1	9.0	4%	2%	(0%)	1%	4.3%	4.3%	4.5%	4.7%
Terna	Neutral	2.68	2.70	2,000	5,405	65%	Dec	16.2	17.2	18.1	17.6	8.7	8.7	9.0	8.9	1%	(1%)	1%	0%	5.2%	5.4%	5.6%	5.7%
EDP	Neutral	4.30	4.44	3,656	16,233	75%	Dec	17.1	18.8	17.9	17.4	12.6	9.9	9.8	9.3	3%	(8%)	(2%)	(1%)	2.5%	2.7%	3.0%	3.2%
Endesa [6]	NR		35.96	1,059	38,082	41%	Dec	15.0	15.9	18.3	17.3	8.8	9.0	9.8	8.3	3%	0%	28%	3%	4.6%	4.7%	4.9%	5.0%
Iberdrola	Buy	11.75	11.11	4,927	54,740	88%	Dec	24.1	22.0	17.0	15.9	13.1	11.2	9.9	9.4	(2%)	(33%)	(2%)	1%	2.4%	2.9%	3.4%	3.8%
Union Fenosa	Buy**	54.0	45.91	305	13,989	59%	Dec	22.3	18.3	15.3	12.2	10.0	8.6	7.7	6.7	5%	2%	7%	5%	2.3%	2.8%	3.5%	4.4%
Gas Natural	Neutral	36.0	42.45	448	19,009	29%	Dec	30.5	21.3	19.7	18.4	12.4	10.1	9.5	8.9	4%	4%	4%	4%	2.3%	2.3%	2.8%	3.0%
Enagas	Neutral	18.0	19.60	239	4,679	95%	Dec	21.6	19.0	16.4	14.6	11.2	10.7	9.8	9.1	(1%)	(1%)	(3%)	(4%)	2.4%	2.7%	3.0%	3.4%
REE	Neutral	29.5	38.75	135	5,242	80%	Dec	26.8	22.4	19.3	17.1	12.2	10.9	10.2	9.6	6%	(3%)	2%	2%	1.9%	2.3%	2.7%	3.2%
CZECH REPUBLIC [CZK] [7]																							
CEZ	Neutral	1,250	1344	592	795,932	32%	Dec	28.7	21.3	14.6	11.4	13.2	11.3	8.6	7.1	3%	4%	7%	8%	1.5%	2.2%	3.0%	4.4%
UK [GBP]																							
British Energy [10]	Buy	672	533	588	3,103	100%	Mar	12.9	16.5	9.8	9.8	4.0	9.0	5.6	5.7	6%	5%	12%	12%	2.6%	6.4%	4.2%	12.1%
Centrica	Neutral	417	369	3,624	13,434	100%	Dec	19.0	11.4	13.5	11.3	7.8	6.0	6.1	5.3	(2%)	9%	5%	8%	3.0%	3.8%	4.1%	4.4%
Drax	Buy	751	676	369	2,493	100%	Dec	6.2	6.4	7.5	8.2	5.0	5.2	6.0	6.6	19%	12%	10%	13%	19.6%	10.4%	11.1%	13.3%
International Power	Neutral	242	489	1,466	7,176	100%	Dec	22.3	19.9	17.5	17.0	12.9	12.3	11.3	10.9	(10%)	6%	5%	6%	1.6%	1.9%	2.3%	2.3%
National Grid	Sell**	646	802	2,720	21,937	100%	Mar	15.7	14.2	14.1	12.9	10.7	9.2	9.1	8.8	(1%)	(13%)	2%	3%	3.6%	3.9%	4.7%	5.1%
Scottish & Southern	Sell	1,210	1,556	863	13,942	100%	Mar	18.0	15.7	15.6	13.0	11.6	10.3	10.1	8.7	2%	4%	2%	5%	3.5%	3.8%	4.0%	4.3%
Kelda	Sell	790	949	361	3,399	100%	Mar	17.3	15.3	13.0	12.0	11.4	9.6	9.4	8.9	1%	18%	3%	5%	3.4%	3.8%	4.0%	4.2%
Northumbrian Water	Neutral	307	329	519	1,704	75%	Mar	16.3	14.8	14.5	14.3	10.2	9.5	9.5	9.3	14%	3%	5%	6%	3.4%	3.7%	3.9%	4.1%
Pennon	Neutral	573	627	356	2,239	100%	Mar	23.8	17.9	14.5	13.6	12.2	10.9	9.7	9.3	(2%)	1%	3%	3%	3.0%	3.1%	3.3%	3.5%
Severn Trent	Neutral	1,396	1,450	233	3,376	100%	Mar	19.6	16.3	14.2	12.4	9.9	9.5	8.9	8.4	5%	(0%)	2%	3%	4.2%	4.5%	4.7%	5.0%
United Utilities	Sell	582	730	875	6,386	100%	Mar	18.6	15.0	17.3	16.8	8.6	9.6	9.1	8.9	5%	19%	0%	5%	6.2%	6.4%	6.6%	6.7%
Biffa	Buy	319	260	350	909	100%	Mar	18.5	17.7	16.1	14.8	8.6	8.2	8.0	7.5	3%	2%	4%	4%	2.4%	2.5%	2.7%	2.9%
Shanks	Buy	287	240	235	565	100%	Mar	19.6	17.7	14.7	13.0	8.6	7.9	7.2	6.6	(12%)	1%	5%	5%	2.5%	2.7%	2.9%	3.3%
Green Utilities [EUR]																							
Acciona	NR		213	64	13,346	40%	Dec	45.5	25.2	27.0	19.9	11.5	12.3	11.0	9.3	(54%)	(26%)	5%	(8%)	1.4%	1.6%	1.8%	2.0%
EDF Energies Nouvelles	Neutral	52	55.37	48	3,153	25%	Dec	142.3	77.3	52.7	39.3	38.9	26.9	19.4	16.1	(11%)	(17%)	(12%)	(16%)	0.2%	0.4%	0.6%	0.8%
Rokas	Buy	25	23.12	24	485	47%	Dec	30.3	35.2	31.9	30.6	16.6	15.3	14.3	12.7	(5%)	(1%)	(19%)	(24%)	0.9%	0.9%	1.0%	1.0%
TOTAL [EUR]					795,260																		
PAN-EUROPEAN AVERAGE [4]								21.6	19.8	17.2	15.3	10.9	10.1	9.2	8.5	5.3%	0.4%	3.1%	2.2%	2.9%	3.2%	3.5%	3.9%

*** Price targets are for a 12-month period, except for Drax and BGY (3 months)**

[1] March year-end companies are aligned to nearest December year end (March 2006/07 equals December 2006).

[2] For definitions please refer to the definitions page.

[3] For the UK companies share price is in GBp.

[4] All averages are weighted by market cap. Biffa, Shanks, Acciona, EDF Energies Nouvelles, Rokas and Séché are not included.

[5] The total market cap is expressed in EUR. The individual market caps for the UK companies are shown in GBP

** Denotes Conviction List membership

[6] Dividend does not include any announced or expected special dividends.

[7] For CEZ the market cap and profitability is in Czech crowns (Kc); EUR=Kc exchange rate c.27.

[8] EPS and EV/EBITDA adjusted with the external capex.

[9] The RWE 2006, Enel 2007E, Iberdrola 2007E and Kelda 2007E and FCF yield are excluded from the average in the respective years.

[10] For BGY all ratios are based on the full dilution of the government's cashsweep into shares.

Source: Company data. Goldman Sachs Research estimates.

Exhibit 18: European Utilities CAGR 2006-09E

Stock	CAGR 06 - 09E Revenues	EBITDA	EBIT	EPS (EBG)	OCF	FCF	DPS
EUROPE							
EDF	3.0%	7.9%	10.2%	7.5%	1.6%	NM	13.6%
Suez	8.4%	12.6%	15.6%	12.0%	6.9%	NM	8.9%
Veolia Environnement	16.5%	17.8%	21.0%	22.5%	8.2%	NM	24.4%
Sèche Environnement	4.8%	7.7%	9.5%	16.9%	14.8%	(0.7%)	21.0%
E.ON	6.1%	11.2%	13.7%	20.2%	16.1%	NM	15.4%
RWE	4.9%	6.6%	9.9%	22.7%	(1.1%)	(57.4%)	(1.0%)
Verbund	13.4%	15.9%	18.0%	18.7%	13.2%	19.6%	15.3%
Fortum	9.0%	17.0%	20.1%	19.5%	18.4%	144.4%	18.9%
AEM	8.6%	3.8%	6.2%	6.8%	(4.1%)	0.2%	12.6%
Enel	10.4%	22.4%	23.1%	16.5%	12.1%	(11.4%)	3.9%
Snam RG	3.4%	4.5%	5.9%	5.9%	3.3%	NM	3.4%
Terna	2.1%	2.7%	1.3%	(2.9%)	(7.8%)	NM	3.5%
EDP	4.3%	14.8%	18.0%	(0.6%)	2.7%	NM	9.3%
Endesa	(3.8%)	(3.1%)	(3.8%)	(4.7%)	(2.3%)	3.8%	2.9%
Iberdrola	26.6%	28.6%	31.6%	15.0%	24.9%	NM	17.1%
Union Fenosa	7.5%	11.5%	14.9%	22.3%	2.4%	(2.7%)	25.0%
Gas Natural	9.0%	10.3%	12.7%	18.2%	2.9%	(5.1%)	9.3%
Enagas	10.8%	11.1%	13.8%	14.0%	13.4%	38.9%	11.7%
REE	7.1%	9.2%	12.1%	16.2%	(11.4%)	NM	18.7%
CZECH REPUBLIC							
CEZ	10.5%	18.7%	27.6%	36.2%	18.5%	42.7%	43.4%
UK							
British Energy	4.4%	5.2%	(3.5%)	9.4%	15.7%	23.6%	68.0%
Centrica	4.6%	11.9%	13.0%	19.0%	55.3%	NM	13.7%
Drax	(4.4%)	(15.4%)	(16.6%)	(9.0%)	(9.0%)	(13.4%)	(12.2%)
International Power	2.7%	4.2%	4.2%	9.4%	2.4%	NM	14.4%
National Grid	14.7%	11.3%	10.6%	6.7%	12.2%	NM	12.2%
Scottish & Southern	4.3%	10.9%	12.3%	11.5%	18.1%	NM	7.0%
Kelda	5.2%	6.8%	8.5%	13.1%	8.0%	NM	7.2%
Northumbrian Water	2.8%	3.7%	3.7%	4.4%	(15.6%)	NM	6.0%
Pennon	9.3%	11.8%	14.6%	20.6%	8.7%	NM	5.5%
Severn Trent	4.7%	8.4%	12.0%	16.5%	14.8%	(14.7%)	5.5%
United Utilities	(4.0%)	(2.7%)	(2.2%)	3.5%	1.8%	(1.9%)	3.0%
Biffa	7.9%	4.8%	10.7%	7.6%	8.2%	10.8%	6.6%
Shanks	5.3%	10.1%	27.2%	14.7%	2.9%	NM	10.0%
Green Utilities							
Acciona	29.8%	56.5%	68.9%	31.8%	61.3%	(46.3%)	12.5%
EDF Energies Nouvelles	22.5%	46.6%	45.9%	53.5%	46.4%	15.2%	54.0%
Rokas	12.8%	19.1%	(17.7%)	(0.3%)	248.2%	72.0%	5.3%
PAN-EUROPEAN AVERAGE[1]	**7.6%**	**11.7%**	**14.0%**	**13.7%**	**9.5%**	**0.9%**	**12.8%**

[1] Biffa, Shanks, Acciona, EDF Energies Nouvelles, Rokas not included

Source: Company data, Goldman Sachs Research estimates.

Although their short term earnings are less geared to higher German prices, E.ON and EDF represent lower risk if power prices increase by less than what is anticipated by the share prices of RWE, Fortum, Verbund and CEZ.

Why German power may not increase to fully reflect higher marginal costs

We are more cautious than the market in terms of expectations for power prices. In the shot term, we believe there are risks as reserve margins may increase, which would keep clean dark spreads low. Medium term, we believe the market needs to reflect the steep downward slope of coal prices.

Reserve margins may actually increase in the short term

There is no doubt that new capacity is required in Germany to replace aging coal assets and potentially to replace nuclear as it is taken off-line. The uncertainty is created by the timing of when new generation comes on-line, when old generation comes off and the share of new capacity from new entrants (so net add) vs. replacement capacity (primarily coming from the incumbent generators).

We see a risk that reserve margins actually increase in the short term and believe this could be one of the reasons why German power prices have not responded more to the increase in forward coal prices.

We estimate 8GW of generating capacity is currently under construction in Germany and a further 32GW is planned (Exhibit 19). Based on the total installed base of 120GW, this represents 7% under contruction and 33% including that planned. We estimate that up to 23% of the total planned capacity could be net add onto the system. As the system is not growing significantly in terms of demand, this may lead to several years of overcapacity. Demand growth over the past few years has been below 1% and peak demand actually fell between 2004/2005 to 2005/2006 (based on data from the VDEW).

Forecasting reserve margins requires assumptions on how many of the plants under construction represent replacement vs. new additions. We expect material net additions over the next few years based on:

- All plants from new entrants will be primarily net additions to the system;
- Incumbents are unlikely to close coal stations during Phase II of the carbon trading scheme as they still receive free carbon allocations for c. 50% of the output;
- Incumbents may be building to provide for future nuclear closures (this may be one of the reasons RWE doubled the size of the lignite plant under construction). Therefore there may be a mismatch in terms of when plant is brought online and when plant is taken out of commission.

Exhibit 19: Incumbent build plans total 19GW

Company	Location	Installed capacity	Planned commissioning date	Project status	Estimated Net add
		MW			MW
Build plans by E.ON, RWE, Vattenfall, EnBW					
Gas					
RWE	Weisweiler	380	2007	operational	380
Vattenfall	Hamburg	130	2007	construction	130
E.ON [60%], (N-ergie, Mainova)	Irsching	820	2008	construction	400
RWE	Lingen	800	2009	construction	800
E.ON [60%], (N-ergie, Mainova)	Irsching	820	2008	construction	357
RWE	Lingen	876	2009	proposed	876
		3,826			**2,943**
Lignite					
Vattenfall	Schwarze Pumpe	30	2008	construction	30
RWE	Neurath	2,100	2010	construction	1,200
Vattenfall	Boxberg	675	2010	construction	0
MIBRAG	Profen	660	2013	proposed	660
		3,465			**1,230**
Hard coal					
Vattenfall	Hamburg Moorburg	1,640	2012	proposed	840
E.ON	Datteln	1,100	2010	proposed	0
EnBW	Rheinhafen	912	2011	tendering	0
RWE	Ensdorf Saarland	1,600	2012	proposed	1,200
RWE, municipalities (23%)	Hamm	1,600	2010	proposed	0
E.ON	Frankfurt	1,100	2014/15	proposed	0
E.ON	Gelsenkirchen	1,100	2015	proposed	
E.ON/Stadtwerke Hannover	Staudinger 6	1,100	2012	proposed	
E.ON	Kiel	800	2014	proposed	
		10,952			**2,040**
Hydro					
E.ON	Waldeck I	70	2008		70
EnBW	Niedersachsen	150	2010/11		150
EnBW	Rheinfelden	74	2011		74
Waste					
Vattenfall	Ruedersdorf	30	2008		30
Vattenfall	Rostock	20	2008	approved	20
Wind					
E.ON, Vattenfall, EWE	Borkum West	60	2008	approved	60
E.ON	Hochsee	400	2008	approved	400
E.ON	Amrumbank West	240		approved	240
E.ON	Juist	280		approved	280
		1,324			**404**
Current build plans by incumbents		**19,567**			**6,617**
% share of total build plans		**49%**			**25%**

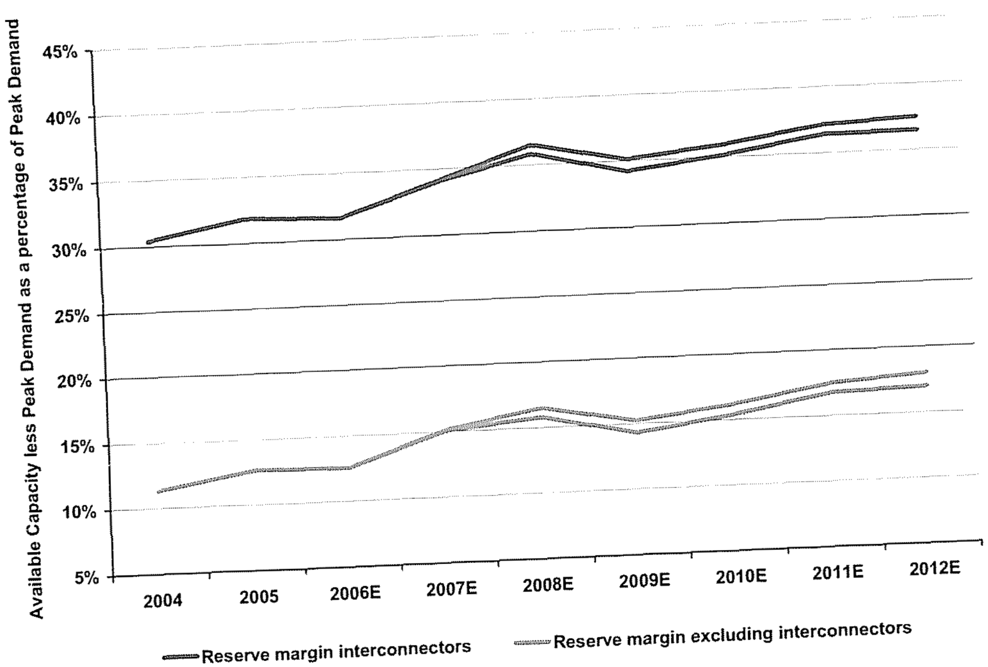
Source: Platts, RWE, E.ON, EnBW, Heren, VDEW, press reports and Goldman Sachs Research estimates.

Exhibit 20: New entrant build plans total 20GW

Company	Location	Installed capacity	Planned commissioning date	Project status	Estimated Net add
		MW			MW
Build plans by others					
Gas					
Mark-E, Statkraft	Herdecke	400	2007	construction	400
Statkraft, Essent, Fortum	Hürth Knapsack	800	2007	construction	800
Trianel	Hamm	800	2007	construction	800
Concord Power	Lubmin	1,200	2009	approved	1,200
Stadtwerke Lippstadt	Lippstadt	260	2009	proposed	260
Advanced Power AG, Siemens, (BKW)	Bocholt	400	2010	proposed	400
Iberdrola	Mecklar-Meckbach	1,000	2010	proposed	1,000
Electrabel	Saarbruecken	400	2008	proposed	400
N-Ergie	Dettelbach	800	2008	proposed	800
Gazprom/Soteg	Eisenhüttenstadt	800	2010	proposed	800
Braunschweiger Versorger AG	Braunschweig	400	2008	?	400
		7,260			**7,260**
Hard coal					
Steag, EVN, (EnBW)	Duisburg/Walsum	750	2010	construction	750
Electrabel	Wilhelmshafen/Stade/Brunsbuttel	1,600	2010	proposed	1,600
Kraftwerke MainzWiesbaden	Mainz	800	2012	proposed	800
Steag, (EnBW)	Herne	750	2011	proposed	750
RheinEnergie	Cologne - Niehl	800	2012	proposed	800
Trianel	Lünen	750	2012	proposed	750
Trianel	Krefeld-Uerdingen	750	2012	proposed	750
Steag, (EnBW)	Lünen	750	2012	proposed	750
DONG Energy	Greifswald	1,600	2012	proposed	1,600
Südweststrom	Wertheim	400	2012	proposed	400
Stadtwerke Düsseldorf	Düsseldorf	400	2012	proposed	400
BKW, Advanced Power	Dörpen (Emsland)	900	2014	proposed	900
		10,250			**10,250**
Hydro					
Rheinkraftwerk Albbruck-Dogern	Albbruck-Dogern	24	2009		24
Pump-storage					
Stadtwerke Ulm	Blaubeuren	45	2010	proposed	45
Waste					
Remondis	Strassfurt	25	2007/08		25
swb Bremen	Location harbour	30	2008		30
Infraserv Knapsack	Huerth	30	2008		30
Huttenwerke Krupp-Mannesmann	Duisburg	300	2009	proposed	300
Progroup	Burg	150	2009	approved	150
Rogesa, Steag, VSE	Dillingen	230	2009	approved	230
Buderus Steel	Dillfield, Wetzlar	40	2009	proposed	40
Salzgitter AG	Salzgitter	220	2010	proposed	220
Wind					
Plambeck Neue Energien, Energi E2	Borkum Riffgrund	231	from 2009	approved	231
Airricity	Butendiek	270	2009	approved	270
Eos Offshore	Hochsee Windpark	400	2009	approved	400
Renergys, Geo	Nordlicher Grund	400	2008/09	approved	400
Offshore Ostsee Wind	Kriegers Flak	332	2010	approved	332
Solar					
juwi	Brandis (leipzig)	40	2010	proposed	40
		2,767			**2,767**
Current build plans by others		**20,277**			**20,277**
% share of total build plans		**51%**			**75%**
Total current build plans Germany		**39,844**			**26,894**
as % of installed capacity in Germany (2006)		*33%*			*23%*
Installed capacity in Germany (2006)		**119,400**			

Source: Platts, RWE, E.ON, EnBW, Heren, VDEW, press reports and Goldman Sachs Research estimates.

Exhibit 21: We forecast a slight increase in reserve margins over time as net additions to the systems outpace demand growth

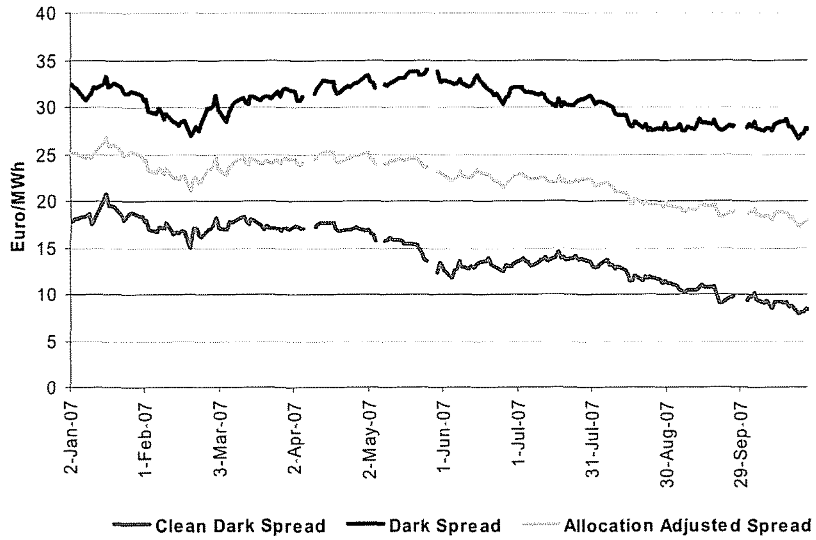


Source: Goldman Sachs Research estimates.

Are the utilities treating the free carbon as the spread?

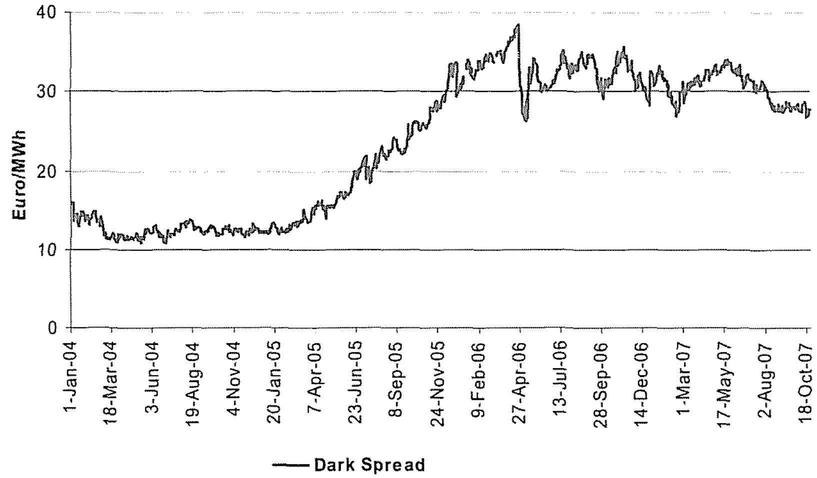
The reduction in the clean dark spreads may be slightly misleading as the German generators will be allocated 50% of their carbon needs for free in Phase II of the ETS (2008-2012). Were the generators to be treating free carbon as a part of the spread, it would be equivalent to an additional €10/MWh for hard coal (Exhibit 23). However, we would be surprised if generators were treating carbon in this way as it would undermine their past statements that opportunity costs of carbon have led to higher power prices.

Exhibit 22: Short term German dark spreads



Source: Goldman Sachs Research estimates, Bloomberg & Heren.

Exhibit 23: Long term German dark spread



Source: Goldman Sachs Research estimates, Bloomberg & Heren.

E.ON and RWE: The political environment continues to deteriorate for the German utilities

- In response to the recently announced tariff increases for January 2008, Germany's Industry Minister, Michael Glos, criticized the utilities. In his view, there is no justification for the increase. Glos explained that the utilities needed to demonstrate higher costs to be able to raise prices and that he did not see the costs rising in the same order of magnitude as the price increases announced.

- **The German government** seems set on creating legislation that will allow for intervention by the Cartel Office into wholesale power markets. This legislation is to shift the burden of proof to the utilities, it allows intervention when generation prices are seen to move beyond what is explicable in terms of costs and will consider a comparison of power prices charged in Germany with prices from similar companies elsewhere. The legislation is to be put into place no later than January 1, 2008 and be in force through the end of 2011.

- **The EU's Competition Commissioner Kroes** recently said the German energy market was "rotten" and vowed to do her utmost to prove it. There are several anti-trust investigations in progress against RWE and E.ON. The case against E.ON concerns suspected market sharing with GdF. The case against RWE concerns alleged obstruction of market access in gas. There has also been speculation that Kroes' team is investigating the German electricity market.

In response to the hostile environment, RWE's new CEO Juergen Grossmann has called upon the energy utilities, industry and government to agree to an Energy Pact for Germany". Dr. Grossmann said the energy utilities will offer investments into energy assets including R&D and a focus on customer needs including exploring options for long-term supply contracts with industrial consumers.

In our view, the risks of the current debate in Germany are focused on increasing regulation of the wholesale power market and for long-term industrial supply contracts below market prices for power. Our forecasts for EON and RWE do not reflect any downside from these risks. Whereas our €144 price target for E.ON reflects €4 of downside from political/regulatory intervention, our €80 price target for RWE does not.

Exhibit 24: European Utilities under coverage: stock-specific risks

Company	Currency	Price Target [12 months][1]	Rating	Risks to Price Target	
Acciona	EUR	-	NR	-	-
AEM	EUR	3.45	Buy	Downside risk:	Falling power price and failure to deliver synergies
Biffa	GBP	319	Buy	Downside risk:	Inability to capture significant growth and a lack of consolidation
British Energy	GBP	672	Buy	Downside risk:	Lower power prices
Centrica	GBP	417	Neutral	Risks:	Lower/higher supply margins; further customer losses
CEZ	CZK	1250	Neutral	Risks:	Fall/rise in power prices, inability to execute regearing and CO_2 allowances allocation
Drax	GBP	751	Buy	Downside risk:	Lower power prices and higher coal prices
E.ON	EUR	144	Buy	Downside risk:	Lower commodity prices, greater political risk and/or value destruction through M&A.
EDF	EUR	92	Buy	Downside risk:	Downside: Lack of tariff increases in France; lower market prices for European power.
EDF Energies Nouvelles	EUR	52	Neutral	Risks:	Delays in the execution of projects; unexpected changes in renewables incentives/regulation
EDP	EUR	4.30	Neutral	Risks:	Failure to grow in renewables; higher/lower wholesale electricity prices
Enagas	EUR	18	Neutral	Risks:	Slower demand growth and higher interest rates; faster demand growth and lower interest rates
Endesa	EUR	-	NR	-	-
Enel	EUR	-	NR	-	-
Fortum	EUR	29	Neutral	Risks:	Lower/higher than expected Nordic power prices, Russian re-investment risk
Gas Natural	EUR	36	Neutral	Risks:	Regulatory changes in gas distribution; M&A developments
Iberdrola	EUR	11.75	Buy	Downside risk:	Failure to deliver growth in renewables, tougher regulation, fall in wholesale prices
International Power	GBP	242	Neutral	Risks:	Recovery in US power prices and growth in project development is quicker than anticipated
Kelda	GBP	790	Sell	Risks:	Duration of return spread (premium to RAV) and a bid from private equity / infrastructure fund
National Grid	GBP	646	Sell**	Risks:	Weaker regulation in the UK
Northumbrian Water	GBP	307	Neutral	Risks:	Duration of return spread (premium to RAV) and a bid from private equity / infrastructure fund
Pennon	GBP	573	Neutral	Risks:	Duration of return spread (premium to RAV) and a bid from private equity / infrastructure fund
REE	EUR	29.5	Neutral	Risks:	Falling/rising interest rates
Rokas	EUR	25	Buy	Downside risk:	Failure to obtain the required regulatory permits on time; unexpected changes in renewables regulations
RWE	EUR	80	Neutral	Risks:	A bid, value from gearing up, higher power prices/lower carbon, use of balance sheet
Scottish & Southern	GBP	1,210	Sell	Upside risk:	Higher power prices for longer; greater returns from growth capex
Séché Environnement	EUR	122	Neutral	Risks:	Acquisition of additional stake in Saur, lack of new water contract wins and operational risks
Severn Trent	GBP	1,396	Neutral	Risks:	Duration of return spread (premium to RAV) and a bid from private equity / infrastructure fund
Shanks	GBP	287	Buy	Downside risk:	Operational factors and a lack of sector consolidation
Snam RG	EUR	4.10	Sell	Upside risk:	Faster demand growth and lower interest rates
Suez	EUR	-	NR	-	-
Terna	EUR	2.68	Neutral	Risks:	Slower demand growth and higher interest rates; faster demand growth and lower interest rates
Union Fenosa	EUR	54	Buy**	Downside risk:	Regulatory changes, fall in wholesale prices
United Utilities	EUR	582	Sell	Upside risk:	Duration of return spread (premium to RAV) and a bid from private equity / infrastructure fund
Veolia Environnement	EUR	59.5	Neutral	Risks:	Continuation of strong growth momentum into the longer term; use of balance sheet
Verbund	EUR	42	Neutral	Risks:	Energy commodities; balance sheet efficiency and M&A

[1] **Price targets are based on SOTP methodology except for CEZ, British Energy and Drax (DCF), Shanks, Biffa and Séché (average of SOTP/DCF and relative P/E multiples). Price targets are for a 12-month period, except for British Energy and Drax (3-months).**

** Denotes Conviction List membership.

Source: Company data, Goldman Sachs Research estimates.

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The precise calculation of each metric may vary depending on the fiscal year, industry and region but the standard approach is as follows:

Growth is a composite of next year's estimate over current year's estimate, e.g. EPS, EBITDA, Revenue. **Return** is a year one prospective aggregate of various return on capital measures, e.g. CROCI, ROACE, and ROE. **Multiple** is a composite of one-year forward valuation ratios, e.g. P/E, dividend yield, EV/FCF, EV/EBITDA, EV/DACF, Price/Book. **Volatility** is measured as trailing twelve-month volatility adjusted for dividends.

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JPMorgan

E.ON and RWE

The sustainability of €60/MWh

Power prices have been rising, and we see more potential upside. RWE looks fully valued, but should remain strong. E.ON remains our key pick on valuation & earnings momentum though.

- **Commodities on the up...but may have further to go**: Gas, coal, CO_2 and power prices have seen strong increases, with the latter hitting the €60/MWh price we highlighted in our October 9 research. However, new entrant margins have not expanded, so we see the potential for power prices to rise further to €70/MWh on the Cal08 and €66/MWh on the Cal10 contracts.
- **Upside risks to earnings & valuation**: Moving to such higher prices would mean raising RWE 2010E EPS by 25%, E.ON by 10%; RWE Sum-of-parts by €11.0/share, E.ON by €8.8/share. Forecast upgrades would need to await: results of 3Q07 and management commentary; whether proposed retail price increases can be made to stick (possibly Jan-08); and some stability in commodity prices.
- **RWE** (N, Dec-08 DCF-based SOP TP €82.2 = 14% downside potential), looks fully valued, even with higher power prices but positive news on further power price hikes, possible IPO of American Water, launch of a buy-back, and expectations ahead of Feb 22 strategy presentation, should mean the shares stay robust.
- **E.ON** (OW, Dec-08 DCF-based SOP TP €155.7 = 16% upside potential) is undervalued in our view, even with our prudent power price & supply margin forecasts. We see the continued consensus earnings upgrade process and completion of the southern Europe asset purchase as positive catalysts for the shares.

Comparative valuation multiples at c-o-b October 30 2007

	2007E	2008E	%sector	2009E	%sector	2010E	%sector
E.ON							
P/E	13.7x	11 2x	71%	10.0x	70%	9 3x	69%
EV/EBITDA	8 8x	8.4x	85%	7.6x	84%	7 3x	84%
Yield	3.2%	4 2%	107%	4 7%	112%	5 5%	120%
RWE							
P/E	18.5x	16 1x	102%	15.5x	109%	15.1x	112%
EV/EBITDA	9 1x	8.7x	88%	8.5x	93%	8 2x	95%
Yield	4 3%	3.7%	95%	3.9%	92%	4.0%	86 3%
Utilities sector							
P/E	18.6x	15.7x		14.3x		13 5x	
EV/EBITDA	10 8x	9.9x		9.1x		8 6x	
Yield	3.5%	3.9%		4.2%		4.6%	

Source: JPMorgan estimates

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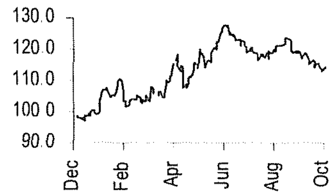
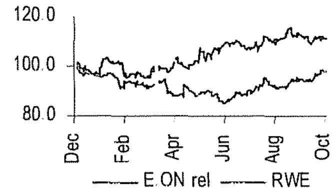
E.ON share price performance relative to RWE (Dec 30 2006 = 100)



Source: Bloomberg

E.ON & RWE share price performance relative to sector (Dec 30 2006 = 100)



Source: Bloomberg

See page 16 for analyst certification and important disclosures, including investment banking relationships.

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Table of Contents

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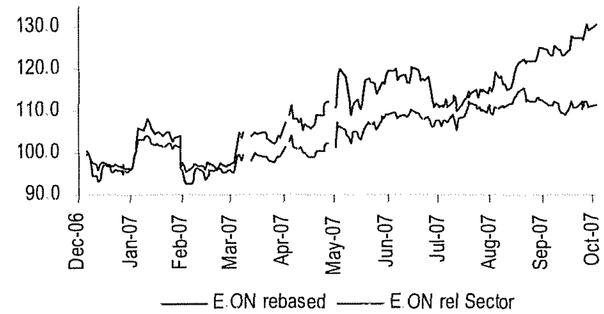
Macro environment

The recent rises in commodity fuel costs have driven up power prices, and also the share prices of the German utilities. We have not seen, however, an expansion in new entrant margins, and so there could be further upside to power prices. Proposed retail power price increases are not yet secure, and we await 3Q07 results on November 13/14 before reconsidering our forecasts and valuations.

Share price performance

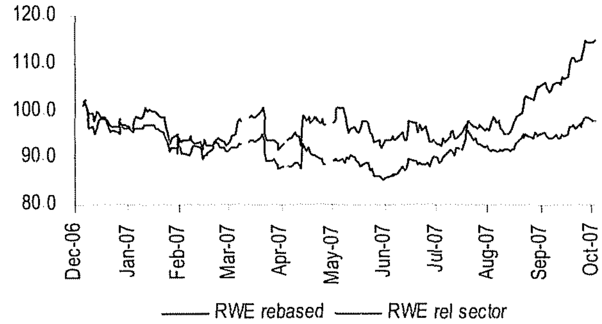
Both German utilities have been strong since mid-year (with RWE starting slightly later than E.ON) on the back of the strength we have seen in commodity prices. As near sector proxies (especially E.ON) their relative outperformance recently has been less marked.

Figure 1: E.ON share price performance & utility sector relative rebased (Dec 29 2006 = 100)



Source: Bloomberg

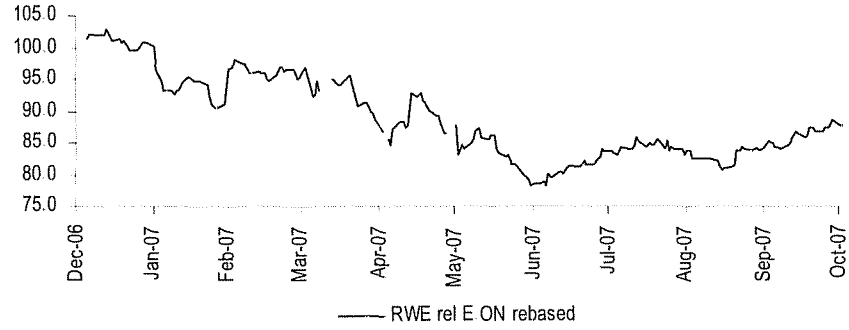
Figure 2: RWE share price performance & utility sector relative rebased (Dec 30 2006 = 100)



Source: Bloomberg

As we had discussed in our recent research ("*Over €60/MWh needed*", October 9 2007) and as we will show during the rest of this report RWE is a more leveraged play on higher commodity prices than E.ON, so recent outperformance by RWE relative to E.ON is unsurprising – although E.ON is still well ahead YTD.

Figure 3: RWE share price performance relative to E.ON rebased (Dec 29 2006 = 100)



Source: JPMorgan estimates.

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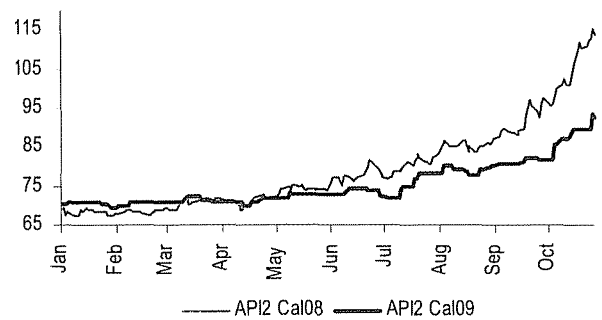
Commodity price movements

Recent price moves - up, up, up

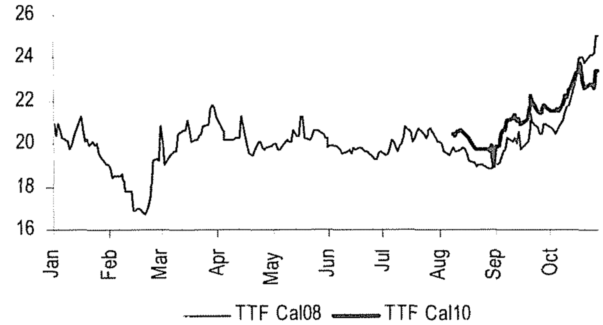
The late 3Q07 and early 4Q07 have seen rapid moves up in commodity prices since our last update earlier in October ("*German power prices - Over 60/MWh needed*", October 9 2007) with both coal (API2) and gas (TTF) reaching new highs on almost a daily basis.

Figure 4: Coal forward prices - API#2 contract, US$/t



Source: Bloomberg

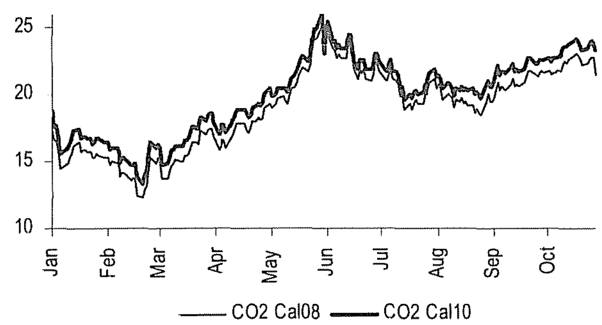
Figure 5: Gas forward price - Title Transfer Facility (TTF), €/MWh



Source: Bloomberg

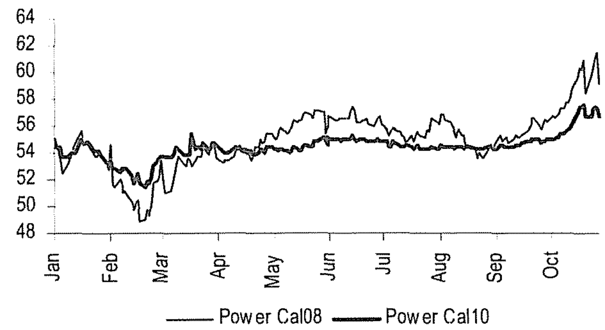
These in turn have pushed up the two energy contracts that derive part of their values from the fuel prices. CO_2 prices for phase 2 have recommenced their upward march, and German forward power prices have done like-wise, again reaching all time highs for the latter.

Figure 6: Forward EU ETS CO2 prices (EUA) - €/t



Source: Bloomberg quoting ICE

Figure 7: Forward German Electricity prices (Baseload), €/MWh

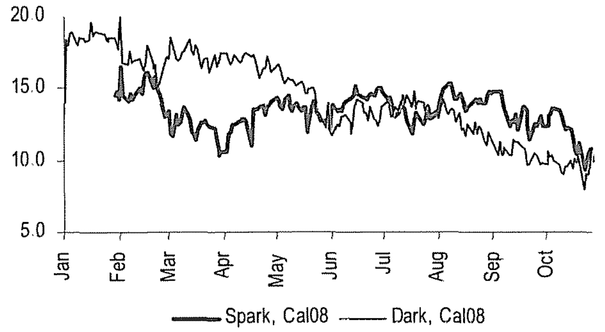


Source: Bloomberg

New entrant margins – down, down, down

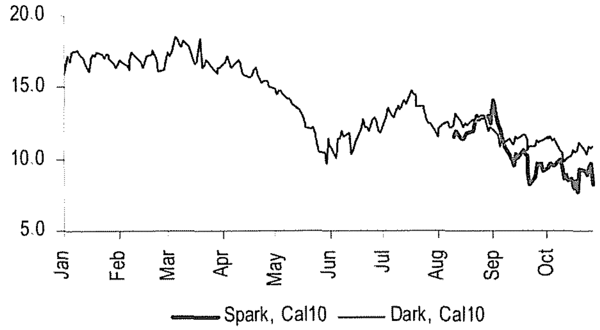
As we discussed in our October 9 note, however, there has not been an expansion in new entrant margins – ie price increases in electricity have been driven almost entirely by higher fuel input costs – and at best there has been a stabilization.

Figure 8: Forward Calendar 2008 gross margins post CO_2 for gas (spark) and coal (dark) fired power plants, €/MWh



Source: JPMorgan estimates

Figure 9: Forward Calendar 2010 gross margins post CO_2 for gas (spark) and coal (dark) fired power plants, €/MWh



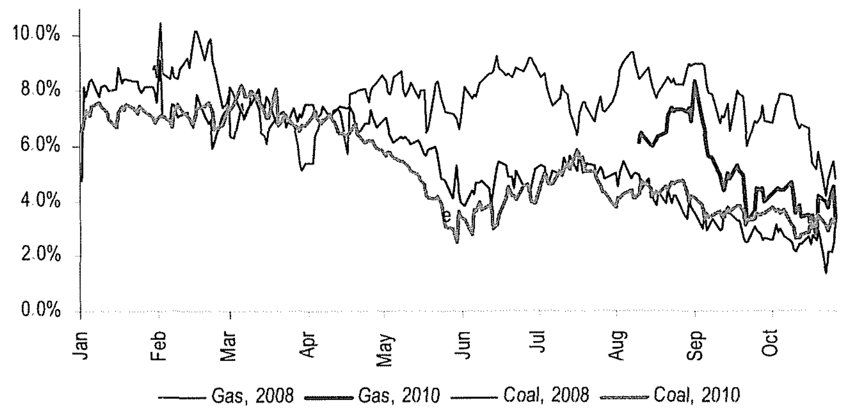
Source: JPMorgan estimates

Commodity price outlook

Higher power prices are good for the profitability and valuation of the German utilities no matter the drivers – they have plenty of fixed cost capacity (nuclear/hydro for E.ON, lignite for RWE) vs their variable cost capacity and CO_2 price exposure to be net beneficiaries. The question, of course, is whether these prices can remain at current levels, or even go higher.

Required new entrant prices suggest further power price increases
Converting our spark / dark spread calculations into implied rates of return shows that prices are not yet remunerating the 9% pre-tax WACC that the utilities generally state by a wide margin. Here we assume €1.1m/MW build cost for supercritical coal & €0.6m/MW for high efficiency CCGTs.

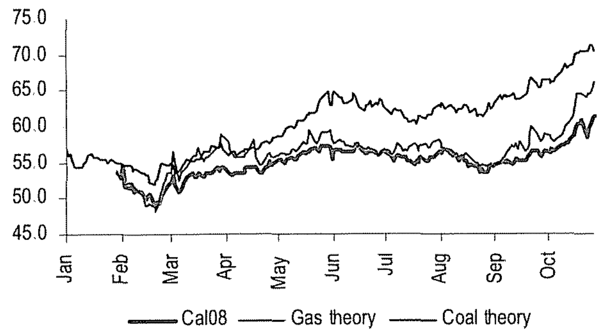
Figure 10: Pre-tax RoIC implied for new gas & coal fired power generating capacity in Germany



Source: JPMorgan estimates.

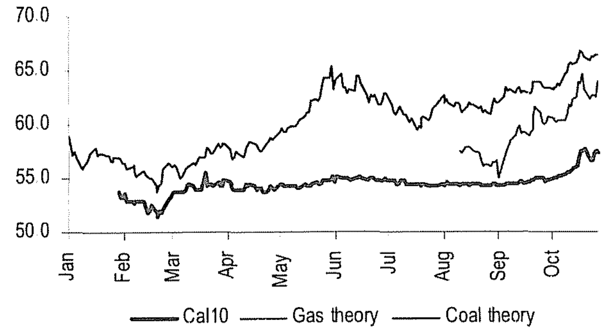
So, assuming spreads recover to a level that will remunerate a 9% pre-tax RoIC long term, then the Cal08 German power contract needs to rise by a further €5 - 10/MWh (8-17%) to €66-72/MWh, and the Cal10 contract by €7-9/MWh (11-16%) to €64-66/MWh.

Figure 11: Theoretical Cal08 power prices based on Gas or Coal fired new entrant power plants vs current Cal08 power prices



Source: JPMorgan estimates

Figure 12: Theoretical Cal10 power prices based on Gas or Coal fired new entrant power plants vs current Cal10 power prices



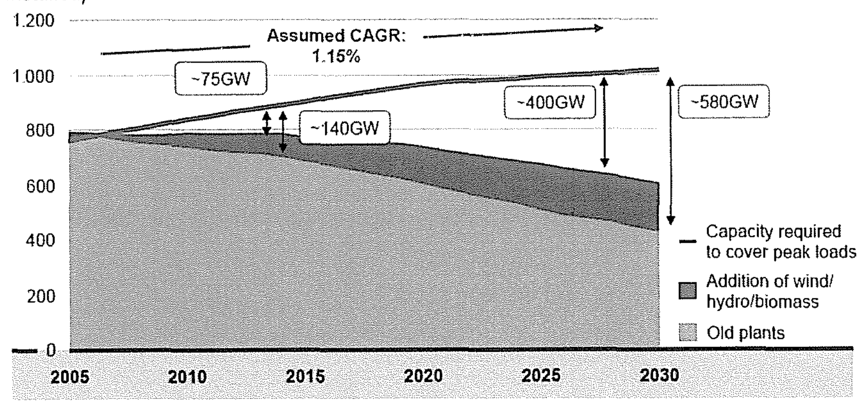
Source: JPMorgan estimates

Sustainability analysis

Can power prices stay at current levels? The answer to this question requires an answer to two questions:

- **Where are commodity fuel prices going?** Our long term forecast of power prices – and basis for our valuation – is based on a commodity "stick" oriented around \$55/bbl oil , \$55/t delivered coal and €30/t CO_2 at US\$1.38/€. Clearly current commodity prices are well above these levels and we'd certainly therefore see our €60/MWh long term power price forecast as being secure. The JPMorgan Oil Team recently upgraded their long term oil price forecast to \$65/bbl, so if anything we'd see upside risk to our forecasts.
- **Where is the supply / demand balance going?** We'd agree with the prognosis of the main utilities that there is a significant supply shortfall emerging in Central and North Europe over the next 10 years as a result of older plant coming offline, and the closure of nuclear power plants as per the consensus agreement between the utilities and the government. This will drive a need for power prices to reflect new entrant levels sooner rather than later.

Figure 13: Need for new thermal power plants by 2020 in EU27, Norway & Switzerland (gigawatts installed)



Source: RWE also citing BCG, EURPROG and UCTE

In conclusion then we'd see the current level of forward power prices as being sustainable, and if anything would see upside risk to power prices if the commodity fuel prices do not come down.

Potential impact on companies

We work on the assumption that hard coal will continue to be the benchmark fuel for pricing in Germany. The table below shows the impact on our forecasts of E.ON and RWE's PBT if we were to "mark-to-market" based on our theoretical prices at 9% pre-tax WACC today. Note that the positive price effect is partly offset by a negative effect from higher coal prices.

As can be seen, RWE is 2.5x more exposed than E.ON with regards to the potential impact on 2010E forecasts, with a 25% potential upside to 2010E forecasts vs 10% for E.ON.

Table 1: Impact of higher prices on forecast profitability

	E.ON			RWE		
	2008E	2009E	2010E	2008E	2009E	2010E
Long volumes - TWh	115.0	115.0	115.0	130.0	130.0	130.0
% Contracted - TWh	75%	55%	0%	85%	25%	0%
Volumes uncontracted - TWh	28.8	51.8	115.0	19.5	97.5	130.0
JPM e forecast price - €/MWh	55.6	54.5	54.4	55.6	54.5	54.4
Theoretical coal based price - €/MWh	**70.4**	**69.0**	**66.3**	**70.4**	**69.0**	**66.3**
Rise in margin - €/MWh	14.8	14.5	11.9	14.8	14.5	11.9
Gained margin - €m	426	752	1,373	289	1,417	1,552
less Lost margin on coal - €m	-58	-75	-178	-40	-143	-203
Net effect - €m	**368**	**677**	**1,195**	**249**	**1,274**	**1,349**
Group PBT - €m	9,692	10,909	11,664	5,025	5,224	5,387
% Group PBT	**3.8%**	**6.2%**	**10.2%**	**5.0%**	**24.4%**	**25.0%**

Source: JPMorgan estimates

From a valuation perspective we consider the scenario of increasing our price forecast to mark-to-market near term but retaining our €60/MWh long term price forecast.

- **E.ON - €8.8/share extra value (c7% of current share price)**: Our E.ON target price would increase by €8.8/share to €164.5/share, or 22% potential upside from today's levels. We would be more than happy, therefore, to retain our OW rating.
- **RWE - €11.0/share extra value (c12% of current share price)**: Our RWE target price would increase by €11.0/share to €93.2/share – still a touch below the current €95.9/share price. We retain our N rating, although potentially we are being pessimistic with regards to supply margins.

As with earnings, then, RWE is more exposed (1.8x in fact) than E.ON to a mark-to-market in power prices.

Table 2: Impact of moving from forward curve to theoretical price on valuations of E.ON and RWE

€m, Dec 31 y/e	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Current forecast curve - €/MWh	55.6	54.5	54.4	54.0	54.2	55.4	56.5	57.7	58.8	55.6
Theoretical price - €/MWh	70.4	69.0	66.3	65.4	64.5	63.6	62.7	61.8	60.9	70.4
€/MWh uplift	14.8	14.5	11.9	11.4	10.3	8.3	6.2	4.1	2.1	14.8
E.ON										
Volumes uncontracted - TWh	28.8	51.8	115.0	115.0	115.0	115.0	115.0	115.0	115.0	28.8
Gained margin net of coal - €m	368	677	1,195	1,137	1,010	950	713	475	238	368
Discounted value - €m	348	605	1,009	908	762	678	480	303	143	348
NPV of gained margin - €m	5,235									5,235
NPV of gained margin - per share	**8.8**									8.8
RWE										
Volumes uncontracted - TWh	19.5	97.5	130.0	130.0	130.0	130.0	130.0	130.0	130.0	19.5
Gained margin net of coal - €m	249	1,274	1,349	1,283	1,139	1,074	806	537	269	249
Discounted value - €m	235	1,138	1,139	1,024	859	766	543	342	162	235
NPV of gained margin - €m	6,208									6,208
NPV of gained margin - per share	**11.0**									11.0

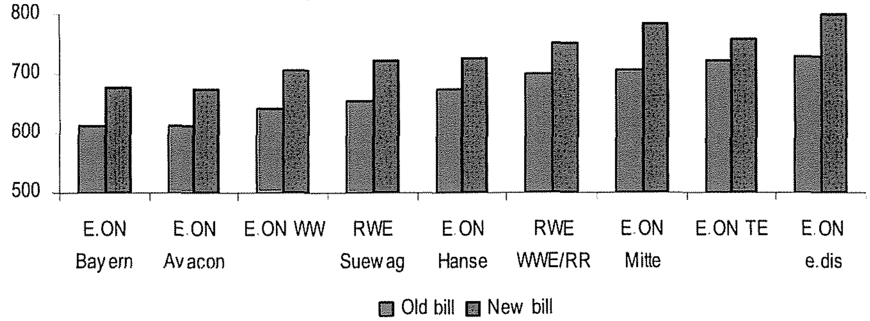
Source: JPMorgan estimates.

Retail market outlook

A major development over the past few weeks has been the decision by the major German utilities (but mostly E.ON and RWE) to raise retail power prices (ie for households) from January 2008. For electricity these have ranged from 4.6 – 9.9% adding €35 – 77/customer in revenues for 2008E vs 2007E.

This, in turn, works out to a €450m revenue hike for RWE and €620m increase for E.ON based on their stated customer supply numbers in Germany.

Figure 14: Selected retail electricity bills - €/customer for 3.5MWh/year



Source: Company data, JPMorgan estimates

These mark the first price moves since the full liberalization of the market in July 2007. Up until this point "in area" suppliers had to gain local authority approval before raising prices.

We'd see these price increases as an important part of ensuring an efficient future market - supply margins are currently very low, with only c 2/3 of price requests historically being allowed. Additionally, prices need to go up to pass through higher renewable energy costs and taxes.

This is where we arrive at the critical point: Politicians across Germany have (unsurprisingly) reacted to these moves in a hostile manner.

The outcome is likely to be that the German Competition Authority (BKartA) will use new powers granted it under the amended competition law (GWB). This allows it to require the utilities to demonstrate why they are setting the prices that they are, rather than requiring the BKartA to prove anti-competitive behaviour. Whilst this was originally designed as a wholesale-market measure with relation to pricing in CO_2, it looks like this can also be applied to retail prices as well.

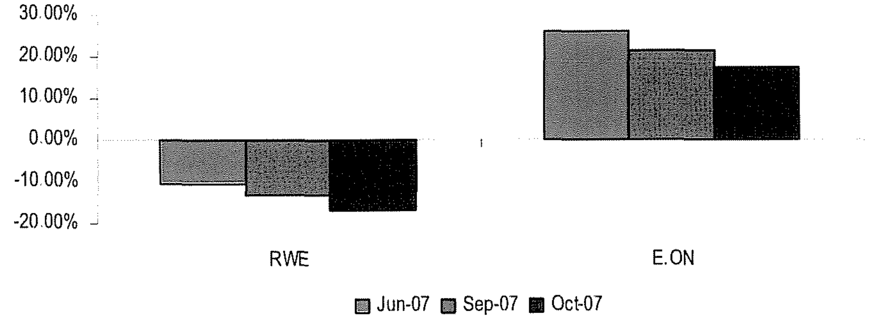
We therefore continue to take the prudent view that the utilities will at least be able to increase prices to cover higher renewable energy costs (a pass-through under the EEG) and government taxes but that supply margin expansion will not necessarily occur.

The quandary of when to revisit our forecasts

By maintaining our current wholesale price forecast, and not assuming supply margin increases we believe that we are being more conservative than consensus in these matters.

This means that we are below consensus for RWE by 16.6% (a widening gap has emerged since Jun-07), but remain above consensus for E.ON by 17.4% (where the gap is narrowing). On the latter we are more bullish on the earnings outlook under the "10 by 10" strategy plan, as discussed in previous research ("*As you like it*", September 26 2007).

Figure 15: Consensus forecasts relative to JPMorgan (-'ve means consensus below JPM E) for 2009E GAAP EPS



Source: Bloomberg, JPMorgan estimates

We see three necessary conditions for us to consider upgrading our forecasts:

- As discussed below, both groups have **3Q07 results** coming up on November 13/14, where we would expect management commentary on both wholesale and retail pricing issues. This will hopefully give some guide as to how they will structure their defenses against the cartel reviews. We don't expect any changes to 2007 guidance or early 2008 guidance from either company.
- We would want to see some sign that the **supply price increases can be made to stick** – this may mean either (a) the BKartA backing off and / or (b) confirmation in January that the proposed price increases actually occur.

- Given the (currently upward) volatility in **commodity prices**, we would want to see a **few weeks of stability** before adjusting our numbers, rather than simply chasing up to find a downgrade is needed. Hopefully the sensitivity tables provided above will give investors some guidance as to our thinking.

Overall, then, we see some upside for earnings, and would see RWE as the more leveraged play on this. However, for **RWE** we believe both consensus earnings and valuations are full, and therefore would only see it as a **momentum-type trading opportunity**. Other catalysts include: potential disposal of American Water proposed by the company and confirmed at the recent capital markets day; possible launch of buy-back programme committed to by management at the recent capital markets day; optimism ahead of the February 22 strategy presentation.

For **E.ON** there is also potential upside to our forecasts, which are already (along with our valuation) ahead of consensus – we see this as a **good quality, 12-month OW recommendation**. Near term we'd look for the completion of the Southern European asset acquisition, and related consensus upgrades (which we generally think have not yet been made) as a potential catalyst for the shares.

E.ON 3Q07 - November 13 2007

E.ON's 3Q07 results should mark a period of calm between a frenetic period of strategic announcements and acquisitions, and the completion early next year of asset acquisitions in southern Europe. We expect these figures to be unremarkable in themselves, but remain OW on grounds of continued earnings upgrade potential.

- **The calm after the storm**: E.ON stock is up by around 20% since its early March lows in both absolute and sector relative terms. The 2Q07 period of strategic announcement, and 3Q07 period of mid-sized acquisitions (in renewables, upstream gas and Russia) have marked a period of significant change for E.ON. We believe most of the in-fill deals are now done, and that the 3Q07 conference call will mark a period of reflection for management.
- **The calm before the storm**: The remaining big event for E.ON is the completion of the acquisition of assets in southern Europe from Enel & Acciona. We would expect substantive announcements on price etc only in 1Q08, but we would look for an update from management on the results call (Nov 13, 2pm GMT).
- **Unremarkable results**: We forecast 9M07 EBIT and recurrent net income growth of c10% year on year, with strength in the wholesale power business being offset by the warm weather earlier this year. Results of this level would leave the group on-track to deliver 2007 guidance of 5-10% EBIT growth. See tables below for more details.

Table 3: E.ON 3Q07 EBIT preview

€m, EBIT	9M05A	9M06A	9M07E	% y-o-y
Group	**5,504**	**6,064**	**6,682**	**10.2%**
Central Europe	**2,945**	**3,243**	**3,439**	**6.0%**
West, Power	2,568	2,643	3,089	16.9%
West, Gas	218	257	122	-52.5%
East	172	243	234	-3.7%
Other / consolidation	-13	100	-6	-106.0%
Pan-European Gas	**1,125**	**1,596**	**1,581**	**-0.9%**
Up/Midstream	712	1,222	1,097	-10.2%
Downstream	405	367	472	28.6%
Other / consolidation	8	7	12	71.4%
UK	**715**	**710**	**1,012**	**42.5%**
Regulated	327	347	377	8.6%
Unregulated / other	388	363	635	74.9%
Nordic	**581**	**437**	**575**	**31.6%**
US Mid-West	**277**	**285**	**266**	**-6.7%**
Corporate Center/other	-139	-207	-191	-7.7%

Source: JPMorgan estimates, Company data.

Table 4: E.ON 3Q07 P&L preview

€m	9M05A	9M06A	9M07E	% y-o-y
EBIT	**5,504**	**6,064**	**6,682**	**10.2%**
Interest expense	-791	-848	-710	-16.3%
Capital gains	403	819	963	
Restructuring costs	-14	0	0	
Other non-operating	31	-2,538	-174	
PBT	**5,133**	**3,497**	**6,761**	**93.3%**
Tax	-1,625	-730	-1,642	124.9%
% rate	*-31.7%*	*-20.9%*	*-24.3%*	
Minorities	-370	-270	-422	56.3%
% share	*-10.5%*	*-9.8%*	*-8.2%*	
Net income from cont	**3,138**	**2,497**	**4,697**	**88.1%**
Net income from discont	3,261	132	-93	
Net income	6,399	2,629	4,604	75.1%
EPS, reported	9.71	3.99	6.05	51.5%
Net income adj	**2,688**	**3,386**	**3,723**	**10.0%**

Source: JPMorgan estimates, Company data

Table 5: E.ON 2007 guidance vs JPMorgan estimates

2007, % y-o-y change	Guidance	JPM e
Group EBIT	**surpass, 5-10%**	**10.5%**
o/w Central Europe	above	14.4%
o/w Pan European Gas	on par	-1.3%
o/w UK	broadly in line, challenging	3.2%
o/w Nordic	significantly above	72.5%
o/w US	below	-4.5%
Group net income	**increase**	**25.8%**

Source: JPMorgan estimates, Company data.

Valuation and Risks to Our Rating & Price Target

We base our €155.7 Dec 2008 target price on a sum-of-parts valuation, itself driven by discounted cash flow analyses for each division. On average we apply a WACC of 6.0% post tax and an average 1.5% terminal growth rate.

Whilst the implied multiple on an EV/EBITDA basis is significantly higher than that for RWE we'd note that (a) the E.ON valuation includes c€20/share from the group's Gazprom stake, which contributes little to earnings, and (b) the growth potential, returns, and average remaining asset life all appear much better for E.ON vs RWE.

Table 6: E.ON sum-of-parts valuation

Division	€ m	€ p.s.	% EV	Comparator	Measure
Central Europe	**56,356**	**94.9**	**39.7%**	**8.9x**	**'08E EBITDA**
Germany	44,555	75.1	31.4%	8.4x	'08E EBITDA
International	11,802	19.9	8.3%	11.7x	'08E EBITDA
Pan-European Gas	**36,349**	**61.2**	**25.6%**	**11.8x**	**'08E EBITDA**
Operating Businesses	24,678	41.6	17.4%	9.1x	'08E EBITDA
Gazprom	11,672	19.7	8.2%	3.0%	'08E Income Yield
United Kingdom	**14,137**	**23.8**	**10.0%**	**7.9x**	**'08E EBITDA**
Energy Services	10,240	17.3	7.2%	9.1x	'08E EBITDA
Generation	5,896	9.9	4.2%	445	GBP/kW
Supply	4,344	7.3	3.1%	350	GBP/customer
Central Networks	3,897	6.6	2.7%	9%	Premium to RAV
Nordic	**16,499**	**27.8**	**11.6%**	**9.9x**	**'08E EBITDA**
LG&E	**4,959**	**8.4**	**3.5%**	**8.2x**	**'08E EBITDA**
Southern Europe	**12,769**	**21.5**	**9.0%**	**7.5x**	**'08E EBITDA**
Spain	5,024	8.5	3.5%	8.1x	'08E EBITDA
Italy	5,728	9.6	4.0%	6.5x	'08E EBITDA
Rest of Europe	2,017	3.4	1.4%	10.2x	'08E EBITDA
Corporate Center and assets	778	1.3	0.5%		
Enterprise Value	**141,848**	**239.0**	**100.0%**	**8.6x**	**'08E EBITDA adj**
Net Financial Position	-21,485	-36.2	-15.1%		'08E Book adj
Provisions	-18,771	-31.6	-13.2%		Sum-of-Parts
Nuclear	-13,656	-23.0	-9.6%		'08E Book
Pension	-2,813	-4.7	-2.0%		'08E Book
Mining / Environmental	-2,302	-3.9	-1.6%		'08E Book
Minority Interests	-11,792	-19.9	-8.3%		'08E Adj Book
Equity Value	**89,800**	**151.3**	**63.3%**	**14.6x**	'08E P/E
Target price	**92,410**	**155.7**			Incl '07E DPS

Source: JPMorgan estimates.

- **Financial risks**: Key risks to our valuation principally relate to: wholesale power prices; the progress of German network regulation; successful implementation of the group's cost cutting and reinvestment programmes. Key risks to our rating are similar in nature given a large part of the OW rating is predicated on steady rises in consensus earnings.
- **Non financial risks**: E.ON is a significant nuclear power operator across Germany and the Nordic markets, and whilst the safety record is impeccable, there have been a number of operational problems recently in facilities where E.ON is an owner, but not the operator. E.ON has significant investments in Russia (somewhat north of €17bn in all, or c20% of market cap) but as far as we can tell all the significant international governance guidelines have been adhered to. E.ON operates a standard German two-board system, and management incentivisation uses a series of operating measures that ensure that shareholders' long-term interests are adhered to.

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RWE 3Q07 – November 14 2007

RWE's 3Q07 results on November 14 are unlikely to be eventful of themselves – the market is likely to look ahead to the FY07 analyst day 100 days later, where new strategy statements should be forthcoming. Catalysts until remain positive, but the stock looks stretched.

- **3Q07 likely to be uneventful**: Following the introduction of the new CEO at the recent UK Capital Markets Day, we would expect the 3Q07 results to be presented on November 14 to be a largely technical affair. We forecast +12% in Operating Profit, +23% in recurrent net income, and unchanged guidance (see tables below).
- **Eyes on Feb 22**: The new CEO, Dr Juergen Grossmann, has committed to detailing his strategic plans for the firm on February 22 2008 at the FY07 results meeting. We would expect this to include: vision of where RWE should "be" from a business & geography perspective in the mid-term; a capex programme up to double the current €25bn level; new earnings and capital structure commitments. We would not rule out, however, acquisitions being made in the mean time - particularly in renewables. We would rule out now though a radical restructuring such as that detailed in our "CEO for a day" research (September 6 2007).

Table 7: RWE Operating Profit divisional forecast

€m	9M05A	9M06A	9M07E	% y-o-y
Operating result	4,179	4,886	5,487	12.3%
RWE Power	1,676	2,284	3,071	34.5%
Generation	1,364	1,822	2,672	46.6%
DEA	312	462	399	-13.6%
RWE Energy	1,871	2,063	1,865	-9.6%
German regions	1,199	1,238	962	-22.3%
International regions	260	310	393	26.8%
Solutions	18	-11	0	
Elec / Gas Transmission	373	617	539	-12.6%
Other	21	-91	-29	-68.1%
RWE npower	303	379	548	44.5%
Water	540	399	311	-22.1%
Other / consolidation	-211	-239	-308	28.9%

Source: JPMorgan estimates, Company data.

Table 8: RWE Group Profit & Loss forecast

€m	9M05A	9M06A	9M07E	% y-o-y
Operating result	**4,179**	**4,886**	**5,487**	**12.3%**
RWE Power	1,676	2,284	3,071	34.5%
RWE Energy	1,871	2,063	1,865	-9.6%
RWE npower	303	379	548	44.5%
Water & Other	329	160	3	-98.1%
Non operating result	-106	-218	-182	-16.4%
Financial result	-1,632	-1,594	-870	-45.4%
Income before tax	2,918	3,549	4,434	24.9%
Tax	-1,071	-1,358	-1,336	-1.6%
% rate	-36.7%	-38.3%	-30.1%	
Income after tax	1,847	2,191	3,099	41.4%
Minorities / Discontinued	-150	-99	-139	40.0%
% share	-8.1%	-4.5%	-4.5%	
Reported net income	1,697	2,092	2,960	41.5%
Recurrent net income	**1,648**	**2,068**	**2,539**	**22.8%**

Source: JPMorgan estimates, Company data.

Table 9: RWE management guidance for 2007 earnings

	Guidance	JPM forecast
Operating result	10-15%	10.3%
RWE Power	Marked improvement, double digit % inc DEA "close down"	19.2%
RWE Energy	-5 to -10%	-10.1%
RWE npower	Clearly up year-on year, double digit %	45.5%
Reported net income	Significant decline	-20.1%
Recurrent net income	At least 15%	18.5%

Source: JPMorgan estimates, Company data

Valuation and Risks to Our Rating & Price Target

We base our €82.2 Dec-08E target price on a sum-of-parts valuation, itself driven by discounted cash flow analyses for each division as at year end 2008, to which we add the dividend to be distributed in May 2008E. On average we apply a WACC of 5.95% post-tax and an average 1.5% terminal growth rate.

Table 10: RWE Group DCF-based sum-of-parts analysis

Division	€ m	€ p.s.	% EV	Comparator	Measure
Power	27,989	49.8	45.7%	6.1x	08E EBITDA
Generation	23,509	41.8	38.4%	6.3x	08E EBITDA
RWE DEA	4,479	8.0	7.3%	5.1x	08E EBITDA
Energy	24,606	43.8	40.2%	8.9x	08E EBITDA
Germany inc Solutions	11,330	20.1	18.5%	8.3x	08E EBITDA
International	6,177	11.0	10.1%	11.0x	08E EBITDA
Transmission Networks	7,099	12.6	11.6%	8.5x	08E EBITDA
npower	8,053	14.3	13.1%	7.7x	08E EBITDA
Generation	5,064	9.0	8.3%	386	GBP/kW
Supply	3,598	6.4	5.9%	383	GBP/Customer
Financial holdings	618	1.1	1.0%		
Enterprise Value	**61,265**	**108.9**	**100.0%**	**7.3x**	08E EBITDA
Net Debt	1,758	3.1	2.9%		
Provisions	-15,869	-28.2	-25.9%		
Nuclear	-9,127	-16.2	-14.9%		
Mining / Environmental etc	-6,741	-12.0	-11.0%		
Minority Interests	-3,264	-5.8	-5.3%	**24.5x**	08E P/E equiv
Equity Value	**43,890**	**78.0**	**71.6%**	**13.1x**	08E P/E equiv
Equity Value with May 2007 dividend	**46,228**	**82.2**		**13.8x**	08E P/E equiv

Source: JPMorgan estimates.

- **Financial risks**: Key risks to our target price and recommendation are commodity price drivers (especially power prices, and hence coal and CO_2 costs), network regulation and deliverable operating margins in the more competitive power markets of the UK and Germany. Key risks to our recommendation relate mostly to strategic moves: a price obtained for American Water higher or lower than our c€7.4bn expectation; significant buy back programme (we factor nothing in our forecasts, but would expect only c5%); radical move into acquisition-led strategy (we factor no change in our numbers, but look for a move to aggressive restructuring).
- **Non-financials risks**: RWE is the largest corporate emitter of CO_2 in Europe, and therefore faces ongoing policy- and reputational-risks. The group's nuclear fleet has historically had good safety records, although the screw-anchor maintenance problem at the Biblis plants has damaged this reputation (although the plant has been safe throughout). RWE is a major upstream oil and gas operator focused on a variety of European and North African states – main issues here are pollution related. Throughout the group RWE's workforce work in hazardous environments, but so far the H&S record of the group has been solid. From a governance perspective RWE has the standard German supervisory/management board system and meets all required standards. We do not yet have clarity on the new CEO's incentive package, but he has committed to reducing his outside board commitments from the current 12.

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Companies Recommended in This Report (all prices in this report as of market close on 30 October 2007, unless otherwise indicated)
E.ON (EONG.DE/€135.81/Overweight), RWE (RWEG.F/€95.90/Neutral), RWE (RWEG_p.F/€85.80/Neutral)

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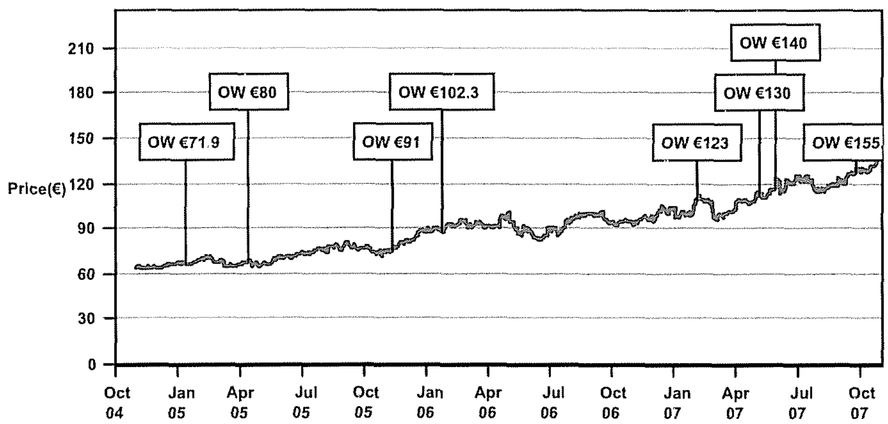
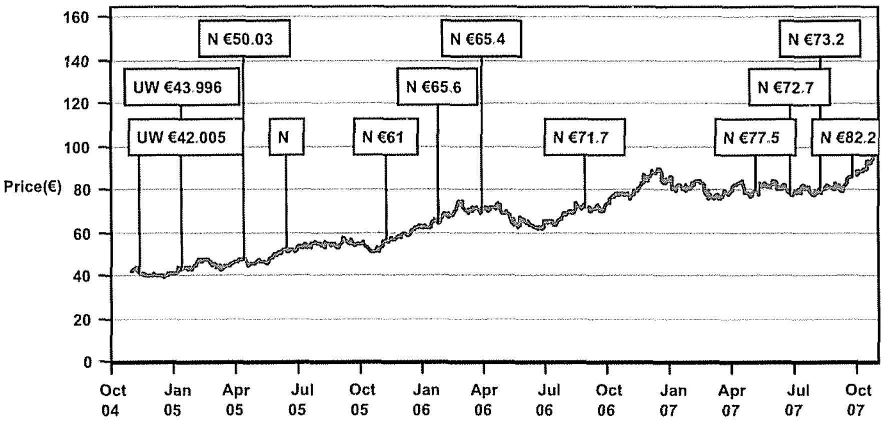
E.ON (EONG.DE) Price Chart



Date	Rating	Share Price (€)	Price Target (€)
12-Jan-05	OW	66.91	71.90
12-Apr-05	OW	67.57	80.00
10-Nov-05	OW	75.00	91.00
23-Jan-06	OW	87.80	102.30
05-Feb-07	OW	108.97	123.00
08-May-07	OW	111.89	130.00
31-May-07	OW	117.35	140.00
26-Sep-07	OW	127.87	155.70

Source: Reuters and JPMorgan; price data adjusted for stock splits and dividends.
This chart shows JPMorgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
JPMorgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

RWE (RWEG.F) Price Chart



Date	Rating	Share Price (€)	Price Target (€)
10-Nov-04	UW	41.90	42.00
13-Jan-05	UW	42.62	44.00
12-Apr-05	N	47.72	50.03
15-Jun-05	N	52.74	--
08-Nov-05	N	57.24	61.00
23-Jan-06	N	64.75	65.60
31-Mar-06	N	70.25	65.40
30-Aug-06	N	71.94	71.70
08-May-07	N	80.00	77.50
25-Jun-07	N	78.46	72.70
09-Aug-07	N	80.25	73.20
25-Sep-07	N	85.66	82.20

Source: Reuters and JPMorgan; price data adjusted for stock splits and dividends.
This chart shows JPMorgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
JPMorgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

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IB clients*	51%	50%	38%
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IB clients*	70%	63%	49%

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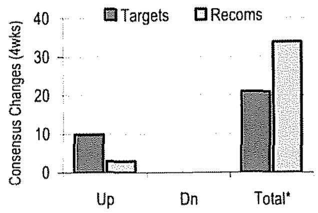
All Data As Of 30-Oct-07

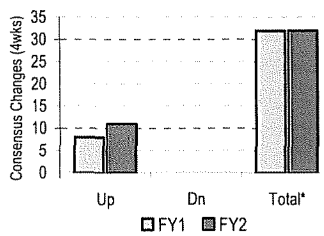
Q-Snapshot: RWE AG

Quantitative Analysis

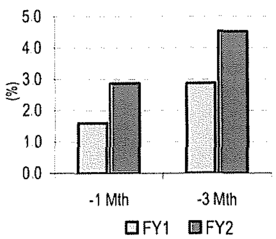
Targets & Recommendations



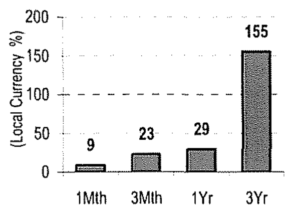
EPS Revisions



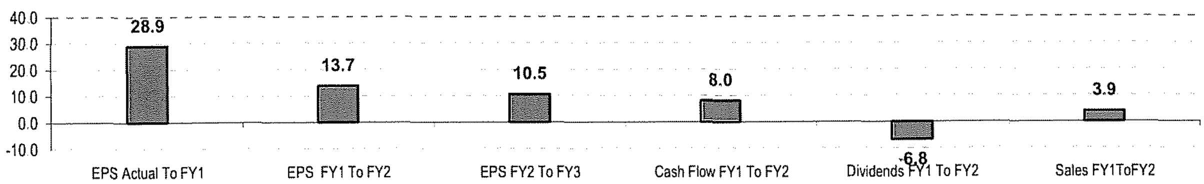
EPS Momentum (%)



Historical Total Return (%)

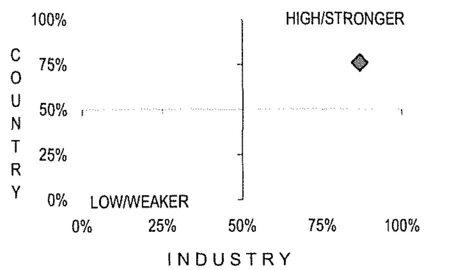


Consensus Growth Outlook (%)



Quant Return Drivers (A Score >50% indicates company ranks 'above average')		
Score 0% (worst) to 100% (best)	**vs Country Peers**	**vs (regional) IBES Industry Peers**
Valuations: P/E Vs Market (12mth fwd EPS)	51%	84%
Valuations: P/E Vs Sector (12mth fwd EPS)	58%	77%
Valuations: EPS Growth (forecast)	51%	74%
Momentum: 12 Month Price Momentum	55%	53%
Momentum: *1 Month Price Reversion*	28%	24%
Quality: Return On Equity (forecast)	76%	76%
Quality: Earnings Risk (Variation in Consensus)	69%	66%
Earnings&Sentiment: Earnings Momentum	79%	79%
Earnings&Sentiment: Change in Recomms	57%	51%
Earnings&Sentiment: Net Revisions Fy2 EPS	89%	79%
COMPOSITE Q-SCORE (0% To 100%)**	76%	87%

JPMorgan Composite Q-Score



Regional IBES Industry Peers (Closest by Size, Consensus. ADV = Average daily value traded in US$m over the last 3 mths)

Code	Name	Country	USD MCAP	ADV	PE FY1	Q-Score**
EDF-FR	Electricite de France	France	218,671	153.40	31.3	57%
EOA-DE	E.ON AG	Germany	127,224	726.87	17.2	84%
IBE-ES	Iberdrola S.A.	Spain	79,624	488.93	21.6	35%
RWE-DE	**RWE AG**	**Germany**	**72,214**	**415.95**	**16.7**	**87%**
GAZ-FR	Gaz de France	France	55,976	72.91	16.7	60%
ELE-ES	Endesa S.A.	Spain	55,235	360.37	14.9	66%
NG-GB	National Grid PLC	United Kingdom	42,324	209.66	14.5	58%
VIE-FR	Veolia Environnement S.A.	France	35,928	158.27	27.4	30%
GAS-ES	Gas Natural SDG S.A.	Spain	27,985	73.04	21.1	59%
SSE-GB	Scottish & Southern Energy PLC	United Kingdom	27,742	175.37	15.4	81%
EDP-PT	EDP-Energias de Portugal S.A.	Portugal	23,076	96.88	18.1	78%

Country Peers (Closest by Size, Consensus. ADV = average daily value traded in US$m over the last 3 mths)

Code	Name	Industry	USD MCAP	ADV	PE FY1	Q-Score**
DAI-DE	Daimler AG	Motor Vehicles	117,275	901.84	16.4	88%
VOW-DE	Volkswagen AG	Motor Vehicles	107,087	501.94	20.7	88%
ALV-DE	Allianz SE	Multi-Line Insurance	97,983	886.32	8.3	52%
INN-DE	ING Groep N.V.		97,544	0.65	6.8	85%
DTE-DE	Deutsche Telekom AG	Major Telecommunications	88,948	515.46	20.7	18%
RWE-DE	**RWE AG**	**Electric Utilities**	**72,214**	**415.95**	**16.7**	**76%**
BAS-DE	BASF AG	Chemicals: Major Diversified	69,474	401.11	13.1	67%
SAP-DE	SAP AG	Packaged Software	65,428	517.60	22.9	34%
BAY-DE	Bayer AG	Chemicals: Major Diversified	63,622	429.02	16.4	65%
DBK-DE	Deutsche Bank AG	Major Banks	63,416	997.42	7.4	24%
POR3-DE	Dr. Ing. h.c. F. Porsche AG	Motor Vehicles	46,543	184.13	16.0	77%

Source: Factset, Thomson and JPMorgan Quantitative Research. For an explanation of the Q-Snapshot, please visit http://jpmorgan.hk.acrobat.com/qsnapshot/
Q-Snapshots are a product of JPMorgan's Global Quantitative Analysis team and provide quantitative metrics summarized in an overall company 'Q-Score.'
Q-Snapshots are based on consensus data and should not be considered as having a direct relationship with the JPMorgan analysts' recommendation
* Total number of target prices, recommendations or EPS forecasts that make up consensus. ** The Composite Q-Score is calculated by weighting and combining the 10 Quant return drivers shown. The higher the Q-Score the higher the one month expected return. On a 14 Year back-test the stocks with the highest Q-Scores have been shown (on average) to significantly outperform those stocks with the lowest Q-Scores in this universe.

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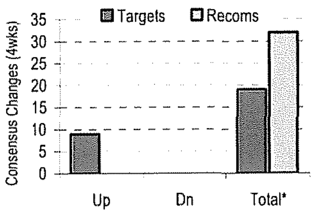
All Data As Of 30-Oct-07

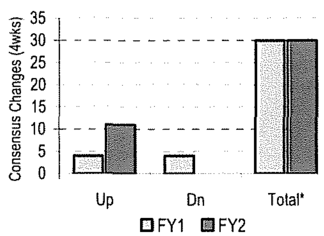
Q-Snapshot: E.ON AG

Quantitative Analysis

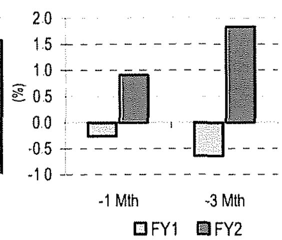
Targets & Recommendations



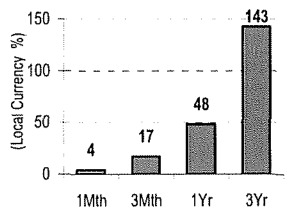
EPS Revisions



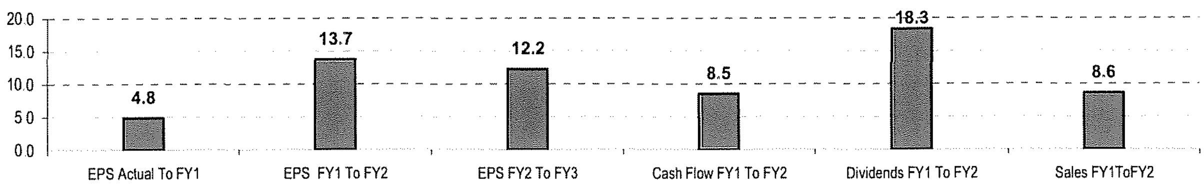
EPS Momentum (%)



Historical Total Return (%)



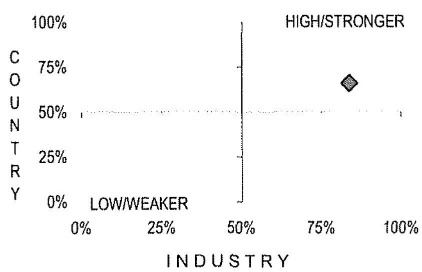
Consensus Growth Outlook (%)



Quant Return Drivers (A Score >50% indicates company ranks 'above average')

Score 0% (worst) to 100% (best)	vs Country Peers	vs (regional) IBES Industry Peers
Valuations: P/E Vs Market (12mth fwd EPS)	48%	82%
Valuations: P/E Vs Sector (12mth fwd EPS)	53%	73%
Valuations: EPS Growth (forecast)	22%	47%
Momentum: 12 Month Price Momentum	69%	80%
Momentum: 1 Month Price Reversion	44%	55%
Quality: Return On Equity (forecast)	29%	38%
Quality: Earnings Risk (Variation in Consensus)	75%	73%
Earnings&Sentiment: Earnings Momentum	59%	53%
Earnings&Sentiment: Change in Recomms	63%	60%
Earnings&Sentiment: Net Revisions Fy2 EPS	89%	79%
COMPOSITE Q-SCORE (0% To 100%)**	66%	84%

JPMorgan Composite Q-Score



Regional IBES Industry Peers (Closest by Size, Consensus. ADV = Average daily value traded in US$m over the last 3 mths)

Code	Name	Country	USD MCAP	ADV	PE FY1	Q-Score**
EDF-FR	Electricite de France	France	218,671	153.40	31.3	57%
EOA-DE	**E.ON AG**	**Germany**	**127,224**	**726.87**	**17.2**	**84%**
IBE-ES	Iberdrola S A	Spain	79,624	488.93	21.6	35%
RWE-DE	RWE AG	Germany	72,214	415.95	16.7	87%
GAZ-FR	Gaz de France	France	55,976	72.91	16.7	60%
ELE-ES	Endesa S A	Spain	55,235	360.37	14.9	66%
NG-GB	National Grid PLC	United Kingdom	42,324	209.66	14.5	58%
VIE-FR	Veolia Environnement S A	France	35,928	158.27	27.4	30%
GAS-ES	Gas Natural SDG S A	Spain	27,985	73.04	21.1	59%
SSE-GB	Scottish & Southern Energy PLC	United Kingdom	27,742	175.37	15.4	81%
EDP-PT	EDP-Energias de Portugal S.A.	Portugal	23,076	96.88	18.1	78%

Country Peers (Closest by Size, Consensus. ADV = average daily value traded in US$m over the last 3 mths)

Code	Name	Industry	USD MCAP	ADV	PE FY1	Q-Score**
EOA-DE	**E.ON AG**	**Electric Utilities**	**127,224**	**726.87**	**17.2**	**66%**
SIE-DE	Siemens AG	Industrial Conglomerates	122,206	975.21	17.0	50%
DAI-DE	Daimler AG	Motor Vehicles	117,275	901.84	16.4	88%
VOW-DE	Volkswagen AG	Motor Vehicles	107,087	501.94	20.7	88%
ALV-DE	Allianz SE	Multi-Line Insurance	97,983	886.32	8.3	52%
INN-DE	ING Groep N V		97,544	0.65	6.8	85%
DTE-DE	Deutsche Telekom AG	Major Telecommunications	88,948	515.46	20.7	18%
RWE-DE	RWE AG	Electric Utilities	72,214	415.95	16.7	76%
BAS-DE	BASF AG	Chemicals: Major Diversified	69,474	401.11	13.1	67%
SAP-DE	SAP AG	Packaged Software	65,428	517.60	22.9	34%
BAY-DE	Bayer AG	Chemicals: Major Diversified	63,622	429.02	16.4	65%

Source: Factset, Thomson and JPMorgan Quantitative Research. For an explanation of the Q-Snapshot, please visit http://jpmorgan.hk.acrobat com/qsnapshot/
Q-Snapshots are a product of JPMorgan's Global Quantitative Analysis team and provide quantitative metrics summarized in an overall company 'Q-Score.'
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* Total number of target prices, recommendations or EPS forecasts that make up consensus. ** The Composite Q-Score is calculated by weighting and combining the 10 Quant return drivers shown. The higher the Q-Score the higher the one month expected return. On a 14 Year back-test the stocks *with the highest Q-Scores have been shown (on average) to significantly outperform those stocks with the lowest Q-Scores in this universe.*

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Valuation snapshots for E.ON & RWE

Table 11: E.ON valuation snapshot at October 30 2007

Sum of Parts, y/e '08E	€m	€p.s.	% EV	'08E EV/EBITDA
Central Europe	56,356	94.9	40%	8.9x
Pan-Euro Gas	36,349	61.2	26%	11.8x
UK	14,137	23.8	10%	7.9x
Nordic	16,499	27.8	12%	9.9x
US Mid-West	4,959	8.4	3%	8.2x
Southern Europe	12,769	21.5	9%	7.5x
Corporate Center	778	1.3	1%	
Enterprise value	**141,848**	**239.0**	**100%**	**9.6x**
less: Net debt	-21,485	-36.2	-15%	-1.4x
less. Provisions/other	-30,563	-51.5	-22%	
Equity Value	**89,800**	**151.3**	**63%**	
Target price *	**92,140**	**155.7**		
Dec 31 y/e, ex Gazprom	**2007E**	**2008E**	**2009E**	**2010E**
P/E	13.7x	11.2x	10.0x	9.3x
Declared Yield	3.2%	4.2%	4.7%	5.5%
FCF Adjusted	-4.6%	-22.8%	-1.9%	-0.9%
EV/EBITDA	8.8x	8.4x	7.6x	7.3x

Source: JPMorgan estimates * Note Target Price = = Equity Value+ dividends & buy back to Dec 08E

Table 12: RWE valuation snapshot at October 30 2007

Sum of Parts, y/e '08E	€m	€p.s.	% EV	'08E EV/EBITDA
Power	27,989	49.8	46%	7.1x
Energy	24,606	43.8	40%	8.4x
nPower	8,053	14.3	13%	8.3x
Other	618	1.1	1%	
Enterprise value	**61,265**	**108.9**	**100%**	**7.8x**
less: Net debt	1,758	3.1	3%	0.2x
less: Provisions/other	-19,133	-34.0	-31%	
Equity Value	**43,890**	**78.0**	72%	
Target price *	**46,228**	**82.2**		
Dec 31 y/e	**2007E**	**2008E**	**2009E**	**2010E**
P/E	18.5x	16.1x	15.5x	15.1x
Declared Yield	4.3%	3.7%	3.9%	4.0%
FCF Adjusted	2.0%	1.4%	2.2%	3.0%
EV/EBITDA	9.1x	8.7x	8.5x	8.2x

Source: JPMorgan estimates. * Note Target Price = = Equity Value+ dividends to Dec 08E

Nomura International plc, London
European Equity Research

NOMURA

E.ON

Proceeding to check out

Year-end 31 Dec	EBITDA (Adj.) €m	Net profit €m	EPS €	PER x	EV/EBITDA x	Adj. free cash flow €m	Adj. cash flow yield %	Div yield %
2005	10,272	7,391	10.7	12.5	10.8	9,423	8.46	1.8
2006E	11,353	5,057	7.3	18.2	9.8	5,425	4.87	5.3
2007E	12,011	5,157	7.5	17.7	9.3	341	0.31	2.8
2008E	12,878	5,651	8.2	16.2	8.6	-3,051	-2.74	3.2
2009E	13,577	6,000	8.7	15.2	8.2	-2,311	-2.08	3.5

Source: Company data and Nomura estimates * *Includes special dividend 2006*

As investor confidence increases, we would expect a further re-rating of the shares, which should close the 15% 2008E EV/EBITDA discount to the sector. Growth for all of the components of E.ON's financial targets to 2010E is virtually secured, in our view, and the foundations are in place to deliver at least 7-9% CAGR in EBIT over 2010-15E. E.ON's attractions as a core holding are now even stronger as the latest acquisitions have enhanced the exposure of the portfolio of businesses to all of our favourite energy themes: *renewables, generation in new growth markets and resource scarcity.* We are re-iterating our Buy recommendation on E.ON with an increased fair value range of €142-157.

Investment points

- **High visibility on 2006-10E sector-beating growth:** 2006-10E estimated EBIT growth of 10% pa is nearly in the bag, in our view, provided execution on the acquisition of the Endesa/Viesgo assets goes according to plan. The contribution from new investments is now secured from the recent acquisitions in renewables and OGK-4, we estimate a total of around €540m (2010E). It should not take anything beyond the already-announced price increases to deliver this growth from the existing business.
- **Foundation set for 2010-15E CAGR of at least 7-9% in EBIT:** We calculate that more than 4% will come from the back-end loaded investment plan to 2010E, where visibility is very high as some of the investments have already been made (upstream) or are in the planning stage (power generation). The uncommitted €10-12bn potentially adds a further 3-4%.
- **Upgrading forecast and fair value:** We are raising our fair value to €142 (from €137), before integration of the Endesa assets, on the basis of our increased growth forecast. A bull case, including power prices at around the €60/MWh level versus our current forecast €55/MWh and the full impact of the share buyback would lift our fair value to €157. We are upgrading our 2010E EBIT forecast by €130m and additional potential from the Endesa/Viesgo assets has not yet been included.

Valuation

Trading at discount to sector. We calculate that E.ON is trading at an 11% 2008E EV/EBITDA discount to the sector. The medium and long-term growth is not fully reflected in the current share price, which implies E.ON ex-growth by 2015E and growth until then at 40bps below the level that should be achievable in our view.

Risks

As a major operator across a range of markets and commodities, E.ON is exposed to country, political, commodity and execution risk. The company is also exposed to regulatory and political risk in several countries. As E.ON owns a 6% stake in Gazprom (OGZD LI, US$49.40, Buy), it is likely to be affected by any risk factors concerning that company. The risk profile might also change as E.ON's portfolio of activities continues to evolve.

Buy (Unchanged)

European Equities

Price (2 November 2007, 08:27)

€132.06

Date

2 November 2007

Market capitalisation

€91,386

No. of shares in issue

692m

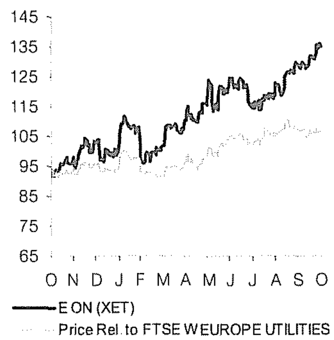
Sector

Utilities

Reuters / Bloomberg

EOA.DE/EOA GR

Share price performance



Source: Datastream

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Investment case

We expect further re-rating as E.ON's highly visible growth is reflected in the share price. The 10-11% 2008/09E EV/EBITDA and P/E discount to the sector should close. The company has invested or committed around €30bn (including Endesa/Viesgo assets) of its €42bn budget and we estimate has virtually secured its targeted near-term growth to 2010E. Post 2010E, we believe growth should still be highly visible, with 4-5% of our estimated total 7-9% 2010-25E EBIT CAGR flowing through from investments committed to at this stage. We re-iterate our Buy recommendation on E.ON as a core holding. We increase our fair value to €142-157.

We believe E.ON has laid the foundations for highly profitable and secure growth with earnings visibility second to none. We estimate that E.ON's target for 2007-10E EBIT growth is virtually in the bag. Our estimate for 2010-15E EBIT CAGR of 7-9% has a high degree of visibility – flowing through from previously-initiated investments and further capex yet to be deployed. The recent acquisitions in renewables and in Russia alone should deliver the €600m targeted contribution to 2010E from new growth investments (excluding the Endesa/Viesgo assets) and capex already committed to should account for around 50% of our post-2010E growth estimate. We consider the earnings mix to be particularly attractive for gaining exposure to all of our preferred energy themes.

- Exposure to renewables is now meaningful and the portfolio is on a par with the largest operators in the renewables space.
- Exposure of the gas business to LNG should be almost comparable to that of Suez/GDF.
- The power generation portfolio should have relatively low CO_2 exposure and a relatively high degree of diversification in the sector with around 13% European market share.

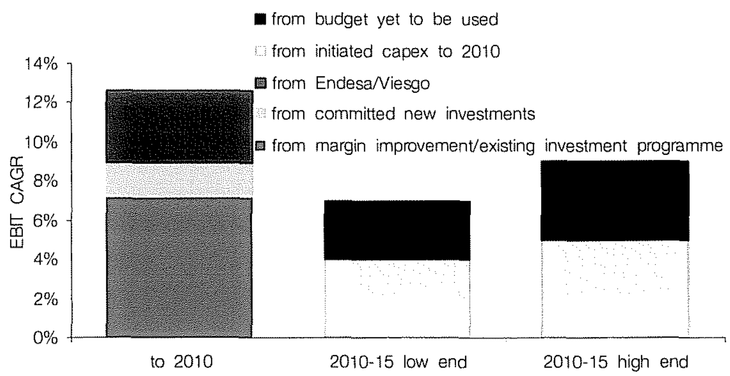
The share price is still not giving full credit to E.ON's growth outlook with only about 90% of our 2015E growth and no long-term growth at all reflected in it despite the high visibility and our view that E.ON should maintain a competitive advantage well beyond 2015. We upgrade our earnings forecasts by 1%, 4% and 2% in 2007, 2008 and 2009 to reflect new insights into growth in Eastern Europe and recent power price increases.

We are upgrading our DCF/SOTP fair value to €142 per share from €137, with further upside potential to €157 from the announced share buybacks and a bullish power price scenario.

As reinvestment risk recedes and growth comes through, we expect the 11% EV/EBITDA (2008E) value gap to close.

Growth and valuation

Visibility of growth



E.ON vs sector peers

	EV/EBITDA 2007E	EV/EBITDA 2008E	EV/EBITDA 2009E
EDF	13.5	12.9	12.4
Suez	9.7	9.1	8.5
Eon	9.2	8.6	8.2
Enel	7.3	7.2	7.1
RWE	9.3	8.8	8.3
Scot & Southern	10.1	9.5	8.9
CEZ	11.7	9.8	9.1
Endesa	8.6	8.2	7.7
Iberdrola	13.1	10.5	9.6
Sector average	**10.27**	**9.41**	**8.86**

Source: E.ON, Bloomberg and Nomura estimates

Proceed to check out

Even with 10% pa EBIT growth to 2010E virtually secured and the foundations laid for post 2010E growth, E.ON still has room to utilise its remaining capex budget to deliver long-term growth in excess of our current expectations. In our view, near-term growth to 2010E is already assured with the potential for margin improvement and the recent string of acquisitions. We are upgrading our forecasts to reflect power price increases and the recently announced targets for Eastern Europe. Our new forecast comes close to the company's €12.4bn 2010E EBIT target on the basis of our forecast €1.3bn contribution from Endesa/Viesgo.

With the first steps already taken on the 2007-10 investment plan, E.ON's earnings mix is shaping up for strong exposure to our preferred energy themes: renewables, scarcity of resources and the power generation cycle. While the foundations have been in place for some time, E.ON is now jumping into the top league in those areas where it has previously lagged behind major players.

- The 10000MW **renewables** pipeline (including the North American and Canadian portfolio) is now up at the top with the largest players. It compares with 40000MW for renewables industry leaders Iberdrola (IBE SM, US$11.18, NR), FPL (FPL US, US$66.46) and Acciona (ANA SM, €211.90, NR), but is in line with EDF Energies Nouvelles's (EEN FP, €54.85, Buy) 10000MW portfolio.
- If all three **LNG** terminal projects are executed, E.ON will have LNG 29bcm/a capacity compared with 34bcm/a for the industry leader Suez/GDF including Suez's Neptune terminal, and almost 950TWh of gas sales compared with 1140TWh for Suez/GDF. It lacks Suez's (SZE FP, €44.57, Neutral) shipping strength, but, in our opinion, that is counterbalanced by the upstream and transport exposure.
- The **generation** portfolio is now one of the most diversified in the sector, both from the perspective of fuel mix and geographic area. About 50% will be carbon free, the highest proportion in the sector along with Suez (except for renewables operators) and should have a meaningful market share around 10-20% in all of its regions, accounting for approximately 13% European market share by 2015 (source. UCTE).

Deliver the goods

Near term plan in the bag: Recent transactions and committed investment are sufficient to guarantee 2010 growth commitment

We estimate that, to date. E.ON has used 75% of its €42bn growth capex budget to 2010, and that the proportion earmarked for renewables has exceeded the €3bn budget by more than 50% if development capex for the acquired assets is included. The OGK-4 acquisition accounts for around 70% of the "neighbouring markets" plan and could absorb as much as 75% when counting in €600m for a mandatory offer.

75% of investment budget deployed to date should deliver 2010E target growth

This, in itself, should easily deliver the targeted €600m EBIT contribution to 2010E from growth investment excluding Endesa/Viesgo, if not more. We estimate a €200m contribution from the renewables acquisitions and €340m from OGK-4 by 2010E. In our view, this has probably to do with E.ON slightly exceeding the renewables budget.

Our growth estimates are based on the following assumptions:

- Renewables remuneration in the US includes only electricity market prices and renewable energy credits.
- Execution on 25% of the development pipeline by 2015.
- 5% CAGR volume growth in Russia.
- 20% pa tariff growth in Russia from 2008 as liberalisation kicks in.
- OGK-4 fuel costs increasing to export levels in line with E.ON's estimate

- Pricing driving margin improvement with no major opex efficiencies at this stage

The impact of production tax credits and accelerated depreciation in US wind are additions to the above. Also, around 1000MW of pipeline will still be outstanding before any replenishment. In Russia, E.ON's follow-up investment programme, increase in-load factors and efficiency improvement should close the gap to the company's targeted US$1bn EBITDA by 2010E.

Beyond these new investments, our current forecast for the underlying growth from existing assets and the impact of the previous growth plan is the main driver underlying our forecast 8.2% EBIT CAGR to 2010E. We expect E.ON to achieve the bulk of this from margin improvement while the impact of organic investment should mainly come after 2010. Upstream growth, power generation capacity build and the impact of power prices are other important factors in our forecast.

Recent acquisitions could mean E.ON exceeding our forecast 2010E EBIT by 2-3%

Adding the recent acquisitions to our forecast could mean E.ON exceeding our estimated €11.1bn 2010 EBIT. Our estimate includes around €100m from the latest update on CEE investment (some of which is probably contained in the "new growth investment" in E.ON's plan). The new Western European generation build plants are also included in our estimates. These account for a further €100m of outperformance compared with E.ONs €10.7bn target before Endesa/Viesgo. Finally, our latest upgrade on the basis of power prices (see below) accounts for the rest of our belief that E.ON can outperform its target by around €400m before the latest investments.

Upgrading our forecast

We are upgrading our forecasts for 2007-10E to take account of increased power prices, the company's price increases in 2008 and the latest update on the impact of generation capacity build up in eastern Europe. Our new EBIT forecast of €11.1bn is almost in line with the company's €12.4bn 2010E EBIT target if we include our estimated €1.3bn contribution from the Endesa/Viesgo assets (please see *E.ON – The next level on*, dated June 2007).

Changes to forecasts

	2007E		2008E		2009E	
	Old	**New**	**Old**	**New**	**Old**	**New**
Sales						
Central Europe	29,103	29,432	30003.61	30,506	30760.57	31,213
Pan-European Gas	25,705	25,705	26214.28	26,307	26728.82	26,809
UK	12,618	12,618	13033.31	13,033	13307.5	13,307
Nordic	3,355	3,355	3392.801	3,393	3443.244	3,443
US	1,998	1,998	2049.906	2,050	2109.217	2,109
Corporate	(3,328)	(3,328)	(3328)	(3,328)	-3328	(3,328)
Total sales	**70,574**	**70,904**	**72,489**	**73,085**	**74145.35**	**74,677**
Adj EBIT						
Central Europe	4,538	4,590	4,787	5,028	5,232	5,356
Pan-European Gas	2,210	2,210	2,414	2,507	2,572	2,652
UK	1,237	1,237	1,382	1,382	1,430	1,430
Nordic	691	691	710	710	721	721
US	380	380	425	425	453	453
Corporate	(400)	(400)	(400)	(400)	(300)	(300)
Total core business	8,655	8,707	9,318	9,652	10,107	10,311
growth	6.9%	7.5%	7.7%	10.8%	8.5%	6.8%
Other	100	100	100	100	100	100
Total EBIT	**8,755**	**8,807**	**9,418**	**9,752**	**10,207**	**10,411**
EPS	7.40	7.45	7.85	8.17	8.48	8.67

Source: Nomura estimates

More to come

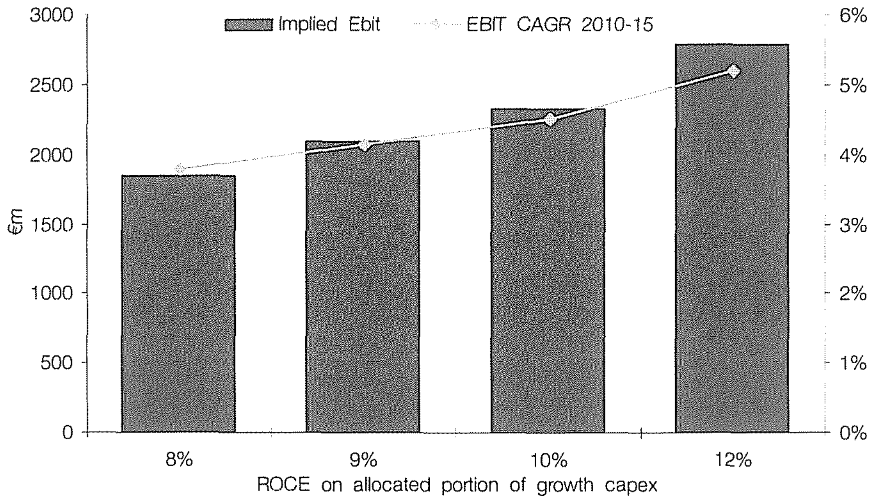
Back-end loaded impact from used budget

As we have outlined previously, E.ON has only just laid the foundation for long-term future earnings growth. The bulk of growth is set to come after 2010E in our opinion.

Of the total €22bn deployed or earmarked for growth investment, about two-thirds, or around €16.5bn, should foster growth post 2010E. We believe that this alone should guarantee 4-5% EBIT CAGR from 2010E, excluding any other growth from existing assets and assuming that all investment have reached their full impact by 2015E at the latest.

Back-end loaded budget impact to bring incremental 4-5% EBIT CAGR 2010-15E.....

EBIT growth contribution 2010-15E from back-end loaded budget



Source: E.ON and Nomura estimates

Unused budget

We estimate that E.ON has at least a further €10bn left for new investments. If we assume a 10-15% ROCE, which would comfortably fit E.ON's investment criteria, this implies €1.3-1.6bn incremental EBIT from such investments. Furthermore, if we assume that this will reach its full impact by 2015E, it would mean a further 3.0-4.0% CAGR in 2010-15E in EBIT.

...and €10bn not yet invested could add a further 3-4% to EBIT CAGR 2010-15E

Potential EBIT growth contribution from capex budget yet to be deployed

	ROCE			Allocated capex (€m)
Segment	**Current**	**EON/Nomura est WACC+50**	**EON/Nomura est WACC+150**	
Power generation	8.50%	7.0%	8.0%	12000
Gas	9.80%	6.3%	7.3%	10000
Renewables	8.50%			3000
Neighbouring markets	10%	11%	11.50%	4600
Total	9.4%	7.1%	8.1%	
	Nopat for ROCE			**Yet to be used (€m)**
Segment	**Current**	**EON/Nomura est WACC+50**	**EON/Nomura est WACC+150**	
Power generation	425	350	400	5000
Gas	686	437.5	507.5	7000
Renewables	0	0	0	0
Neighbouring markets	200	210	230	2000
Total	1311	997.5	1137.5	14000
EBIT CAGR contribution 2010-15E	3.8%	3.1%	3.4%	

Source: E.ON and Nomura estimates

What are the prospects and over what time frame are they likely to contribute?

Power generation

We calculate there is still €5bn to be allocated from the €12bn budget, excluding the 15GW of projects E.ON is currently screening in Eastern Europe. Spain, France and Italy are likely to absorb a major portion, most of which will probably be connected to the Endesa/Viesgo assets.

We assume:

- €55-60 wholesale power prices
- €20/t CO_2
- No free allocations
- GBp 30/th gas and US$ 96/sht coal

New coal plant can generate around 8.5% ROCE as baseload plant. We still believe that gas will be run as mid merit and peak plant. In the UK, Southern Europe and CEE, we forecast that gas will achieve ROCEs up to 8-9.5%.

ROCE calculation for new plant

Coal (baseload)				Gas (mid merit/peak load)			
Electricity	**55**	**58**	**65**	Electricity	**58**	**65**	**75**
Efficiency	46%	46%	46%	Efficiency	55%	55%	55%
Fuel (US$/sht)	70	85	100	Fuel (GBp/th)	40.00	45	55
CO_2 (€/t)	20.0	21.0	23.0	CO2 (€/t)	20	21	23
Clean Spark spread	23.6	22.5	24.6	Clean dark spread	21	18.5	21.6
ROCE	7.3%	8.4%	9.3%	ROCE	5.87%	6.5%	7.8%

Source: Nomura estimates

Power generation, gas and new markets should be the next areas of reinvestment

All of this indicates a possible achieved ROCE range of 6.0-9.5%. The resulting €400n EBIT should add to long-term growth post 2010.

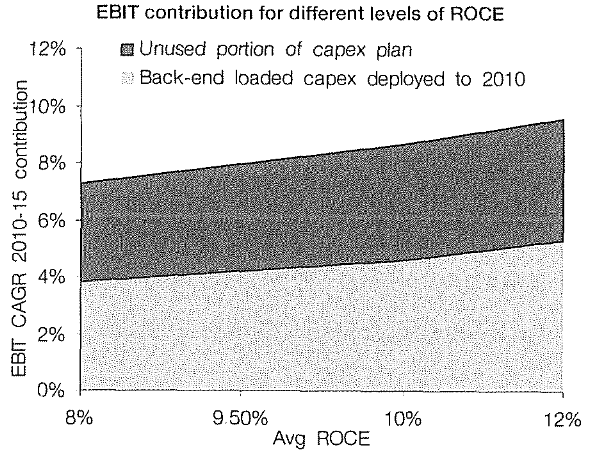
Gas

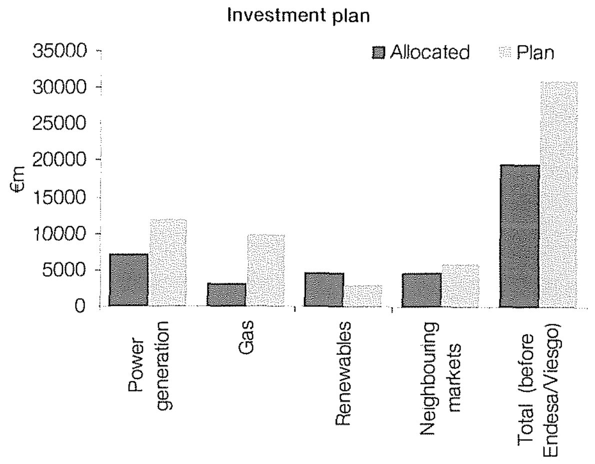
This is the area with the second largest gap between currently committed investments and targeted amounts. The recent Skarv-Idun acquisition leaves around €3bn for further upstream projects while about 40% of the LNG budget of €2bn could still be available after the Wilhelmshaven, Krk and Le Havre projects. Furthermore, the €2bn earmarked for storage is still untouched. We believe a €600-700m EBIT contribution from all of the above is possible.

New markets

We think that this is the part of the pot that could grow at rates above expectations. The current budget implies virtually nothing for Turkey when taking into account the budgeted €1.2bn for privatisations and buyouts in the CEE plan. However, Russia probably exceeded the original budget, so E.ON could be willing to commit around €2-3bn to Turkey plus any investment in other new markets.

EBIT contribution from investment plant and committed investments vs plan





Source. E.ON and Nomura

Valuation unwrapped

In our opinion, the share price is still not giving full credit to E.ON's growth outlook. Only about 90% of our 2015E growth estimate and no long-term growth at all is reflected in the price despite high visibility and our view that E.ON should maintain a competitive advantage well beyond 2015E. In addition, as investor confidence in the growth outlook increases, we also expect the 11% and 10% 2008E EV/EBITDA and 2009E P/E discount to the sector to close. We are upgrading our fair value to €142-157 (from €137).

Gapping the disbelief

No credit in the share price even for virtually secured growth

We believe that the share price is still discounting execution risk on the investment plan, giving hardly any credit to the company's growth prospects, not even those of the existing business. The share price does not fully reflect potential growth to 2010E or longer-term prospects, let alone the latest acquisitions.

It appears to be discounting only:

- 7.4% growth to 2010E or
- 5.8% cash flow CAGR 2007-15E versus our 6.2% forecast before acquisitions and
- E.ON going ex-growth thereafter with no excess returns
- No upside to current forward power prices to eternity

Growth and drivers implied in the current share price

Growth to year	**2010E**	**2015E**
EV	116,294	116,294
PV of FCF	(554)	16,455
Implied TV	116,848	99,838
Years to maturity	10	5
Terminal and mature excess growth	8.5% / 0%	8.5% / 0%
Terminal and mature excess return	3.5% / 0%	3.5% / 0%
Implied terminal FCF (6.6% WACC)	7,213	9,000
Implied CAGR 2007-TV year	*7.4%*	*5.8%*
Nomura E CAGR 2007-TV year	*7.4%*	*6.2%*
2007-TV year CAGR drivers included?		
-Margin improvement	✓	(✓)
-Power prices	(✓)	--
-Recent acquisitions	--	--
-Endesa/Viesgo	--	--
-Further investment to plan	--	--

Source: Nomura estimates

Fair value upgrade

Base value

Fair value upgraded to €142

We are revising our base fair value to €142 (from €137) to reflect the latest updates on Eastern Europe and power price increases.

E.ON sum-of-the-parts

	EV €m	Methodology	% of EV	Implied EV/EBITDA 2008E
Central Europe	46,427	DCF	39.2%	7.3x
-Pan European Gas	24,934	*DCF*	*21.0%*	8.8x
UK	*13,166*	*SOP*	*11.1%*	6.8x
-Generation/Supply	6,318	*capacity multiples*	*xx*	
-Regulated business	3,804	RAB - 10% premium	*3.2%*	
-Other supply	3,929	EV/EBITDA 07		
-Other/consolidations	(886)	EV/EBITDA 07		
Nordic	9,388	DCF	*7.9%*	8.5x
US	4,945	DCF		7.8x
Corporate centre (non-UK)	(1,618)	6x EV/EBITDA 2007		4.0x
Utilities	**97,241**		*82.0%*	**7.6x**
Financial investments	**21,297**		*18.0%*	
TOTAL EV	**118,539**		*100.0%*	**9.2x**
Debt	1,941			
Minorities	(4,917)			
LT provisions	(17,400)			
Equity	**98,163**			
No of shares	142			

Source: Nomura estimates

Add-ons

Share buybacks add €1-5 per share

Assuming that E.ON executes €3bn of its €7bn share buyback would add a further €1.0-2.50 per share to our valuation. The remaining portion would add a further €1.30-3.30.

€16 for re-leveraging based on new target capital structure

The WACC benefit from re-leveraging could bring an additional €16 per share. We estimate that E.ON should reach a gearing ratio around 39% of total capital under its new debt target on the basis of total economic debt as per E.ON's definition.

Bullish power price scenario: additional €10 per share

While 2008 and 2009 forward electricity prices are currently trading around €61/MWh, we have maintained our forecast of an average €55/MWh as some of the recent spikes have probably been driven at least in part by a number of nuclear outages and colder-than-average temperatures. Our power price scenario might be conservative in light of a tightening CO_2 outlook well above €20/t and continuously high fossil fuel input costs. If we incorporated a €60/MWh 2008 and 2009 power price into our forecast followed by a long term €55/MWh, our fair value would increase to €145. A bullish scenario of €60/MWh to 2015 lifts our fair value to €152.

Sector comparison: high quality goods at discount price

10% value gap to close growth comes through

E.ON's share price is now trading at 11% (2008E) below our current sector average EV/EBITDA and at a 10% 2009E P/E discount despite highly visible EBITDA and earnings growth. Reinvestment risk, increasingly diminishing, should accelerate a re-rating. We continue to believe that a premium rating is warranted as a reflection of the company's benchmark qualities and its unique position across the energy value chain.

Peer group valuation (as at 02 November, 08:30)

	Price	P/Sales			P/E		
	(€/GBp)	2007E	2008E	2009E	2007E	2008E	2009E
EDF {EDF FP}	83.4	2.53	2.47	2.38	33.39	32.11	29.60
Suez {SZE FP}	45.3	1.23	1.17	1.12	18.42	18.06	17.30
E.ON {EOA GR}	**132.1**	**1.29**	**1.25**	**1.22**	**17.72**	**16.17**	**15.23**
Enel {ENEL IM}	8.3	1.38	1.32	1.29	15.61	15.83	15.92
RWE {RWE GR}	95.0	1.16	1.15	1.14	19.67	18.18	15.55
Scot. & Southern {SSE LN}	1568.0	1.16	1.15	0.01	15.57	14.64	14.03
CEZ {CEZ CP}	1360.0	4.56	4.10	3.88	22.26	16.83	15.14
Endesa {ELE SM}	36.4	0.18	1.72	1.66	14.71	13.74	12.81
Iberdrola (IBE SM)	11.3	3.20	2.54	2.33	21.99	18.74	16.88
Sector average		**1.85**	**1.88**	**1.67**	**19.93**	**18.25**	**16.94**

	EV/EBITDA			Yield			P/CF		
	2007E	2008E	2009E	2007E	2008E	2009E	2007E	2008E	2009E
EDF	13.5	12.9	12.4	*1.5%*	*1.6%*	*1.7%*	13.8	13.1	12.3
Suez	9.7	9.1	8.5	*3.0%*	*3.0%*	*3.2%*	8.7	8.2	7.6
E.ON	**9.2**	**8.6**	**8.2**	***2.8%***	***3.2%***	***3.5%***	**10.3**	**9.2**	**8.6**
Enel	7.3	7.2	7.1	*5.2%*	*5.2%*	*5.1%*	8.8	8.3	7.9
RWE	9.3	8.8	8.3	*3.8%*	*3.3%*	*3.2%*	7.5	7.0	6.8
Scot. & Southern	10.1	9.5	8.9	*3.7%*	*4.0%*	*2.4%*	12.0	11.1	10.9
CEZ	11.7	9.8	9.1	*1.9%*	*2.6%*	*3.0%*	13.1	11.0	10.3
Endesa	8.6	8.2	7.7	*4.3%*	*4.6%*	*5.1%*	7.9	7.6	6.9
Iberdrola	13.1	10.5	9.6	*2.6%*	*3.0%*	*3.4%*	14.3	12.0	10.9
Sector average	**10.27**	**9.41**	**8.86**	**3.2%**	**3.4%**	**3.4%**	**10.73**	**9.70**	**9.13**

Source: Bloomberg and Nomura estimates

Financials

E.ON: Profit and loss					
€m	2005	2006	2007E	2008E	2009E
Sales	68 883	70 574	70 904	73 085	74 677
growth	22.1%	2.5%	2.9%	3.1%	2.2%
Central Europe	29 504	30 227	30 556	31 630	32 337
Pan-European Gas	24 987	25 705	25 705	26 307	26 809
UK	12 569	12 618	12 618	13 033	13 307
Nordic	3 204	3 355	3 355	3 393	3 443
US	1 947	1 998	1 998	2 050	2 109
Corporate	(3 328)	(3 328)	(3 328)	(3 328)	(3 328)
Total revenues	56,399	70 574	70 904	73 085	74 677
Growth	20.7%	2.5%	2.9%	3.1%	2.2%
Adjusted EBITDA	10,272	11,353	12 011	12 878	13 577
EBITDA margin	18.2%	16.5%	16.9%	17.6%	18.2%
Growth			5.8%	7.2%	5.4%
Depreciation	(2,939)	(3 203)	(2 844)	(2 767)	(2 906)
Provisions		195	195	205	216
Other operating expenses					
EBIT	7,333	8,150	8 807	9 752	10 411
Growth	8.0%	11.1%	8.1%	10.7%	6.8%
Operating margin	13.0%	11.8%	12.4%	13.3%	13.9%
Net financial result	(1,027)	(1,081)	(734)	(865)	(987)
Other financial income	(291)	(394)	(201)	(201)	(201)
Other non-operating income	886	(1,936)	500		
Income from continuing operations	7,192	5,133			
		-28.6%			
Non recurring	0	0	0	0	0
Pre-tax profit	7,192	5,133	7 872	8 686	9 223
Growth	13.2%	-28.6%	53.4%	10.3%	6.2%
Tax	(2,276)	323	(2 165)	(2 432)	(2 582)
Tax rate	32%	nm	28%	28%	28%
Net income	4,916	5,456	5 707	6 254	6 640
Growth	9.1%	11.0%	4.6%	9.6%	6.2%
Minorities	(553)	(526)	(550)	(603)	(640)
Income from disc'd operations	3,028	127			
Net profit	7,391	5,057	5 157	5 651	6 000
Growth	70.3%	-31.6%	2.0%	9.6%	6.2%
Yr end number of shares	692	692	692	692	692
Avg number of shares	692	692	692	692	692
EPS	10.68	7.31	7.45	8.17	8.67
EPS from cont operations	6.30	7.12	7.45	8.17	8.67
Growth	8.3%	13.0%	4.6%	9.6%	6.2%
DPS	2.75	3.42	3.73	4.25	4.60

Source: Company data and Nomura estimates

E.ON: Adjusted EBIT by segment

€m	2005	2006	2007E	2008E	2009E
Central Europe	3 930	4 168	4 590	5 028	5 356
Pan-European Gas	1 536	2 106	2 210	2 507	2 652
UK	963	1 229	1 237	1 382	1 430
Nordic	806	619	691	710	721
US	365	391	380	425	453
Corporate	(399)	(416)	(400)	(400)	(300)
Total core business	7 201	8 097	8 707	9 652	10 311
Growth	*7.8%*	*12.4%*	*7.5%*	*10.8%*	*6.8%*
Other	132	53	100	100	100
Total EBIT	7 333	8 150	8 807	9 752	10 411
Growth	*8.0%*	*11.1%*	*8.1%*	*10.7%*	*6.8%*

Source Company data and Nomura estimates

E.ON: Balance sheet

€m	2005	2006	2007E	2008E	2009E
Intangible assets	4 125	3 749	3 373	3 007	2 623
Goodwill	15 363	15 124	15 124	15 124	15 124
Tangible assets	41 323	42 712	48 781	59 402	69 801
Financial assets	21 686	27 613	28 113	28 113	28 113
-Companies accounted for under equity method		7 967	7 967	7 967	7 967
-Others	21 686	19 646	20 146	20 146	20 146
Total fixed assets	82 497	89 198	95 391	105 646	115 661
Inventories	2 457	3 990			
Receivables	21 354	19 754			
Payables	(5 288)	(5 305)			
Working capital	18 523	18 439	18 353	18 263	18 172
Other assets	5 135	957	957	957	957
Total assets	**106 155**	**108 594**	**114 701**	**124 866**	**134 790**
Share capital	1 799	1 799	1 799	1 799	1 799
Net profit	25 861	26 304	28 882	31 586	34 398
Reserves	17 080	19 972	19 972	19 972	19 972
Treasury stock	(256)	(230)	(230)	(230)	(230)
Shareholders' funds	44 484	47 845	50 423	53 127	55 939
Minorities	4 734	4 917	5 214	5 539	5 883
Special concession accounts	0	0	0	0	0
Provisions	33 862	31 977	31 782	31 577	31 361
Long term liabilities	12 416	11 392	14 818	22 161	29 145
Short term liabilities					
Cash & cash equivalent	(15 119)	(13 333)	(13 333)	(13 333)	(13 333)
Net debt	(2 703)	(1 941)	1 485	8 828	15 812
Other liabilities	25 778	25 796	25 796	25 796	25 796
Total shareholders' funds & liabilities	**106 155**	**108 594**	**114 701**	**124 866**	**134 790**

Source: Company data and Nomura estimates

E.ON: Cash flow					
€m	**2005**	**2006**	**2007E**	**2008E**	**2009E**
EBIT	7 333	8 150	8 807	9 724	10 383
Depreciation	2 939	3 203	2 844	2 767	2 906
Provisions	(367)	1 800	(195)	(205)	(216)
Working capital requirement	(3 779)	(1 291)	86	89	91
Tax	(2 276)	0	(2 165)	(2 424)	(2 574)
Other movements	3 311	(3 200)	(500)	0	0
Operating cash flow	**7 161**	**8 662**	**8 879**	**9 950**	**10 589**
% change	*-5.1%*	*21.0%*	*2.5%*	*12.1%*	*6.4%*
Cash conversion	70%	76%	76%	80%	80%
CFPS	10.35	12.52	12.83	14.38	15.30
CF after interest	*5 843*	*7 187*	*7 943*	*8 884*	*9 401*
Capex	(4 337)	(6 437)	(8 538)	(13 021)	(12 921)
Other					
Disposals	6 599	3 200			
Free cash flow	**9 423**	**5 425**	**341**	**(3 071)**	**(2 332)**
% change	*69.6%*	*-42.4%*	*-93.7%*	*-1000.6%*	*-24.1%*
FCFPS	13.62	7.84	0.49	-4.44	-3.37
Interest	(1 318)	(1 475)	(936)	(1 066)	(1 188)
Dividends	(1 903)	(5 307)	(2 578)	(2 929)	(3 170)
Minority dividends	(245)	(242)	(253)	(277)	(294)
Dividends received	0	0	0	0	0
Change in net debt	5 957	(1 599)	(3 426)	(7 342)	(6 984)

Source: Company data and Nomura estimates