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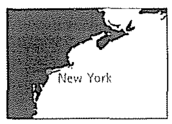

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JPMorgan

German Utilities

FY07 meetings positive, regulation potentially negative, upgrading target prices

EONG.DE
Overweight
€148.10
11 January 2008
Price Target: €173.50

RWEG.F
Neutral
€97.10
11 January 2008
Price Target: €94.80

We upgrade our power price forecasts and target prices for E.ON and RWE, and see trading upside potential ahead of the FY07 results. Through the year, though, regulatory and competition review worries may weigh on the shares.

- **Upgraded forecasts**: We have upgraded our German power price forecast to €65/MWh long term from €57/MWh on higher commodity costs. We have incorporated higher supply margins in line with recent price increases, but see downside risks later in 2008 from the new competition reviews. There is also downside risk should incentive network regulation from 2009 include one-off upfront costs instead of a "glide-path" approach.
- **E.ON – OW on earnings upgrade potential:** We upgrade our Dec-08 SoP based target price from €155.4 to €173.5/share. We think the stock is undervalued relative to the sector, and see around c10% upside to '08E consensus EPS – the March 6 analyst meeting and acquisition completions should drive the ongoing upgrade process. We keep our long-term OW and would use any weakness on regulatory worries as a buying opportunity. (See Table 22 for details of forecast revisions.)
- **RWE – N on value, short term upside on strategy:** We upgrade our Dec-08 SoP based target price from €82.7 to €93.8/share. We think the stock is fully valued at these levels, and believe consensus is about right given current strategy plans. The stock has upside potential ahead of the February 22 strategy presentation, but longer term remains the more exposed stock to regulatory concerns in Germany. (See Table 34 for details of forecast revisions.)

European Utilities

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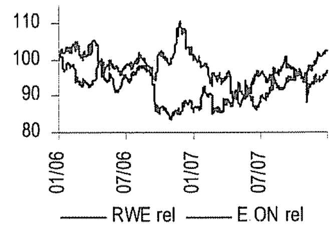
E.ON & RWE share price performance relative to Utilities sector



Source: Datastream

Table 1: Valuation comparison for utilities with exposure to German power prices

	E.ON *	RWE	Fortum	EDF
Share price	148.1	97.1	29.2	80.2
Target price	173.5	93.8	31.0	83.0
% upside potential	17%	-3%	6%	3%
P/E 2009E	11.1x	14.0x	15.4x	22.4x
EV/EBITDA 2009E	8.0x	8.0x	10.2x	10.1x
Yield + Buy back to Dec-08	8.0%	3.1%	4.5%	1.7%

Source: Datastream, JPMorgan estimates. Prices at close-of-business January 11, 2008. * E.ON multiples adjusted for Gazprom stake

J.P. Morgan Securities Ltd.

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Company Data

Price (€)	148.10
Date Of Price	11 Jan 08
52-week Range (€)	154.04 - 94.50
Mkt Cap (€ bn)	97.6
Fiscal Year End	Dec
Shares O/S (mn)	659

E.ON (EONG.DE;EOA GR)

	2006A	2007E	2008E	2009E	2010E
EBITDA FY (€ mn)	11,353	12,088	14,851	16,782	18,222
EBIT FY (€ mn)	8,150	8,975	11,055	12,731	13,871
Adj. EPS FY (€)	6.65	7.78	9.81	11.24	12.41
Dividend (Gross) FY (€)	3.35	4.39	5.54	6.18	7.44
Adj P/E FY	22.3	19.0	15.1	13.2	11.9
EV/EBITDA FY	11.4	10.8	9.7	8.6	8.0
Gross Yield FY	2.3%	3.0%	3.7%	4.2%	5.0%
FCF Yield FY	-2.4%	-2.7%	-18.1%	-1.1%	0.0%

Source: Company data, Reuters, JPMorgan estimates.

Company Data

Price (€)	97.10
Date Of Price	11 Jan 08
52-week Range (€)	102.26 - 74.24
Mkt Cap (€ bn)	54.6
Fiscal Year End	Dec
Shares O/S (mn)	562

RWE (RWEG.F;RWE GR)

	2006A	2007E	2008E	2009E	2010E
EBITDA FY (€ mn)	7,172	8,525	8,623	9,471	9,936
EBIT FY (€ mn)	5,681	6,606	6,843	7,531	7,853
Adj. EPS FY (€)	4.38	5.01	6.25	6.94	7.23
Dividend (Gross) FY (€)	3.50	3.01	5.00	4.16	4.34
EV/EBITDA FY	11.1	9.4	8.5	8.0	7.7
Adj P/E FY	22.1	19.4	15.5	14.0	13.4
Gross Yield FY	3.6%	3.1%	5.2%	4.3%	4.5%
FCF Yield FY	1.6%	2.0%	0.9%	2.0%	2.9%

Source: Company data, Reuters, JPMorgan estimates.

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Investment thesis

We have upgraded our power price and supply margin forecasts for Germany. However, we see downside risks from competition and regulatory reviews later in 2008. We see significant potential upside from RWE's analyst presentation, but the shares have factored a lot of this already. We prefer E.ON on valuation.

New wholesale power price forecast

We have upgraded our wholesale power price forecast for the German market from €57/MWh to €65/MWh. This is based on a move to our sector assumption of a fuel stick equivalent to $65/bbl oil, and retaining our phase 3 CO_2 price assumption of €30/t. We'd note that oil prices above this level are largely irrelevant as new gas-fired power plants move firmly out-of-the-money relative to coal.

Short-term prices should remain robust as they are still below new entrant levels given current fuel costs. This move adds €1.2bn to our 2012E PBT forecast for RWE (87% of our total upgrade made today of 26% to 2012E PBT), and €0.7bn for E.ON (around 44% of our 12% upwards revision).

Downside risks from German network and retail prices

We have upgraded our forecasts for both companies by around 3% at the PBT line to allow for the expansion in supply margins generated by Jan-08 price increases in Germany. We still see a risk from the new competition review launched by the BKartA that may result in some sort of compromise agreement that could erode the higher margins. An outcome here, though, could take 12 months.

The clock is now ticking with regards to setting prices for German networks for 2008-2013. Our initial view is that the pricing formulae will end up more-or-less with flat-nominal percentage progression over the period. However, we are concerned that recent press reports may suggest the regulator is considering a "P0" cut that could reduce prices by 20-25%. The downside risk is 13-15% of PBT for RWE, and 7-9% for E.ON. We see a low likelihood of this scenario emerging, but clearly see a risk of negative developments during the year.

Strategy updates on the way, especially for RWE

RWE management are scheduled to release their long awaited new strategy plan on February 22. We see significant balance sheet potential – at least €25bn and up to €34bn of additional investment / value return beyond the existing €5bn per year plan. This could generate a 4 year EBIT growth target of 10-18%, dividend growth of >13% underlying, and perhaps a 5-10% buy-back programme as well. As an illustration, a capex uplift of €25bn could drive earnings accretion of 24% for 2010E, and value accretion (including tax shield) of c€18/share assuming a 1% outperformance of WACC.

E.ON's strategy & targets were already laid out in great detail in May 2007. However, we may see an expansion of the capex budget (currently €60bn on projects committed by 2010E) and whilst EBIT targets could go up (currently €12.4bn for 2010E, we see upside to €13.9bn, or 12% higher) we'd see a lower probability given the negotiations ongoing with Enel / Acciona and Statkraft and previous management practice (shown by 2003-2006's "on.top" programme".

RWE a short term buying opportunity, but prefer E.ON on valuation

From a valuation perspective, we upgrade our SoP based target price on E.ON from €155.7 to €173.8/share, and on RWE from €82.7 to €93.8/share. This leaves E.ON still looking significantly cheaper than RWE as well as the two main local peers Fortum and EDF.

Table 2: Comparative valuation multiples - prices at close January 10, 2008

					P/E		EV/EBITDA		Yield	
	Rec	Price	Target price	% upside	'08E	'09E	'08E	'09E	'08E	'09E
E.ON	OW	148.1	173.5	17%	12.3x	11.1x	8.8x	8.0x	3.7%	4.2%
RWE	N	97.1	93.8	-3%	15.5x	14.0x	8.5x	8.0x	5.2%	4.3%
Fortum	N	29.2	31.0	6%	16.7x	15.4x	11.1x	10.2x	3.8%	4.1%
EDF	N	80.2	83.0	3%	28.3x	22.4x	11.5x	10.1x	1.8%	2.0%
Utilities sector	.	701	736	5%	18.3x	15.7x	9.6x	8.7x	4.2%	4.1%

Source: Datastream, JPMorgan estimates.

In the near term, we would see potential for outperformance from RWE ahead of its FY07 results and associated strategy update on February 22. We'd see the potential for upside to earnings and valuation as being bigger proportionately than that for E.ON which reports on March 6. We would need to see a very significant plan, however, to support anything well beyond the current share price.

Looking further into 2008, however, we'd see the emerging risks from the German competition review and network regulation as carrying downside risks to which RWE is more exposed.

As a result we retain our fundamental OW and preference for E.ON.

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Central Europe power price forecast

We upgrade our long-term power price forecast from □57/MWh to □65/MWh on the back of higher fuel cost assumptions. We also upgrade our RWE 2012E PBT by 26% (of which 87% from higher power price forecasts) and E.ON by 12% (of which 44% from higher power prices).

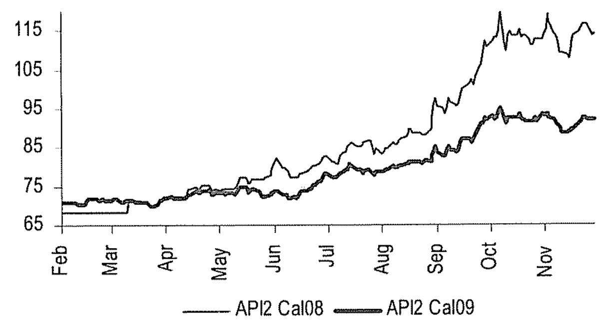
Short term – Development of margins

Commodities have remained strong, and whilst the Cal10 German power price has begun to strengthen, clean dark and spark spreads continue to remain well below new entrant levels.

Commodity prices – Staying up

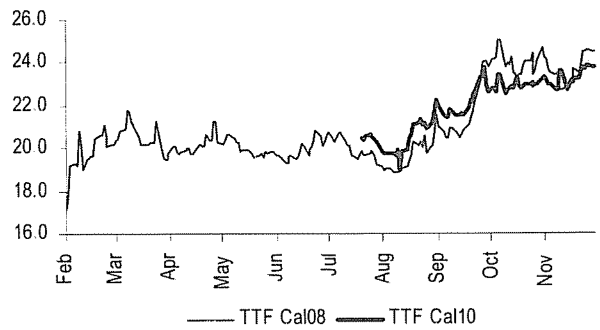
Coal and gas prices have remained high – if volatile – since our last review of the German energy market (see "*The sustainability of □60/MWh*", Nov 1 2007) with Cal08 coal running at €110/t and Cal09 gas at €25/MWh. The emergence of more "normal" (ie cold) winter months at the near-end coupled with continued strength in international demand for coal and LNG have kept prices up, we believe.

Figure 1: Coal forward prices - API#2 contract, US$/t



Source: Bloomberg

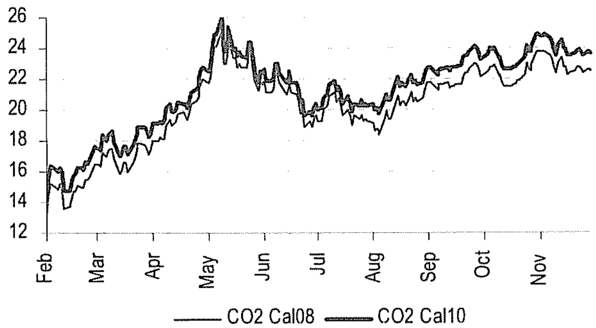
Figure 2: Gas forward price - Title Transfer Facility (TTF), €/MWh



Source: Bloomberg

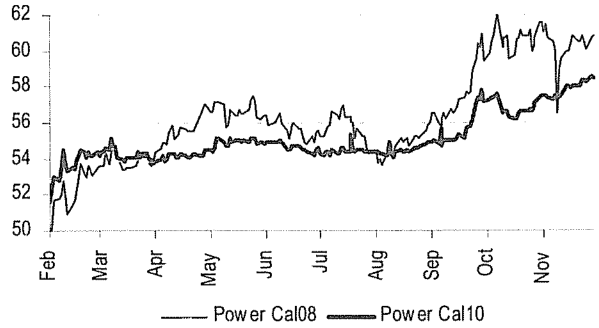
Looking at the derivative contracts, though, CO2 for 2008-2012 delivery has now stabilised at the c€23/t territory and electricity (particularly the Cal08 contract) has managed a steady upward trend.

Figure 3: Forward EU ETS CO2 prices (EUA) - €/t



Source: Bloomberg

Figure 4: Forward German Electricity prices (Baseload), €/MWh



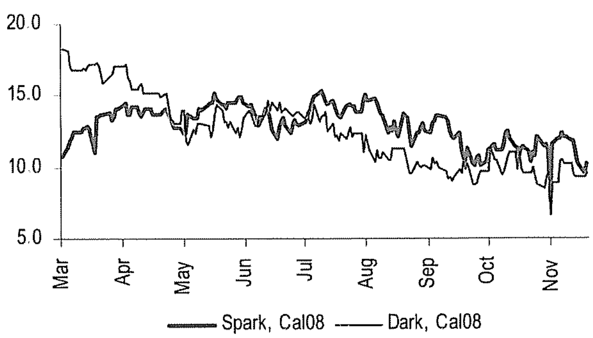
Source: Bloomberg

New entrant spreads – End of year report: Must try hard

In general spreads on the Cal08 contract have been very weak during 4Q07, although we'd argue this is of little relevance to the utilities given their forward contracting was generally done at an earlier period.

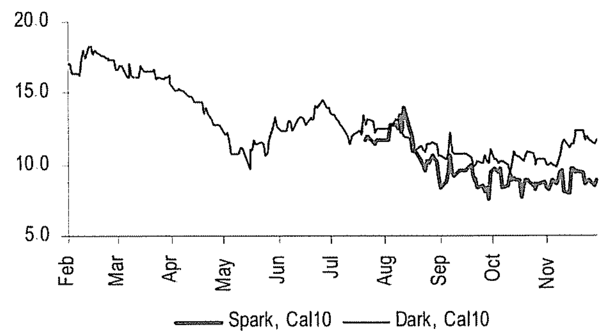
The more important Cal10 contract is beginning to do better – particularly on the critical dark spread – but remains well below the >€20/MWh clean dark spread and >€15/MWh clean spark spread needed to incentivise new entrants.

Figure 5: Forward Calendar 2008 gross margins post CO2 for gas



Source: JPMorgan estimates

Figure 6: Forward Calendar 2010 gross margins post CO2 for gas



Source: JPMorgan estimates

Long term - New entrant pricing

We have upgraded our long-term electricity price forecast for the Central European market to €65/MWh by 2015E from $57/MWh previously. By coincidence the break-even of coal- and gas-fired new entrant power plants are at similar levels assuming:

- **Fuel costs**: We base our long-term gas forecast on the equivalent of $65/bbl oil, and coal on $50/t (API2 contract). We'd note that the JPMorgan house oil forecast is $75/bbl, although this becomes largely irrelevant as at oil prices above $65/bbl oil *ceteris paribus* gas moves out-of-the-money relative to coal.
- **Carbon**: We continue to factor in a €25/t phase 2 (2008-12) and €30/t phase 3 (2013-2020) prices for EUAs.

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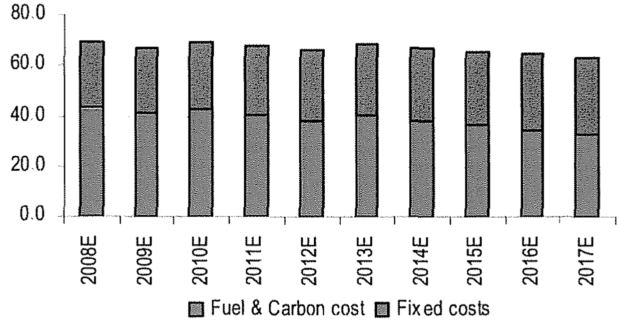
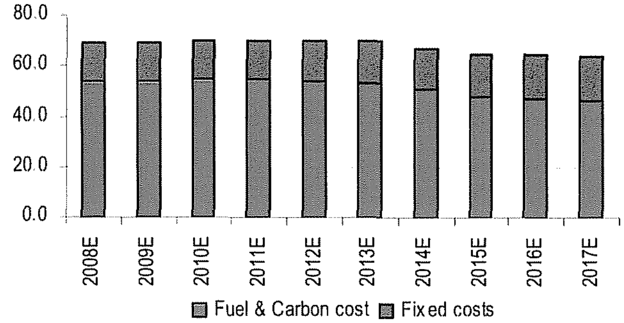
- **Efficiency factors**: New gas plants are expected to deliver thermal efficiency levels of 57.8%, and new coal plants of 44% (perhaps prudent vs new super-critical plant being quoted by manufacturers at 46%). We have based our calculations on both plant types running in the base-load.

Figure 7: Break-even new entrant coal-fired generating costs - €/MWh



Source: JPMorgan estimates

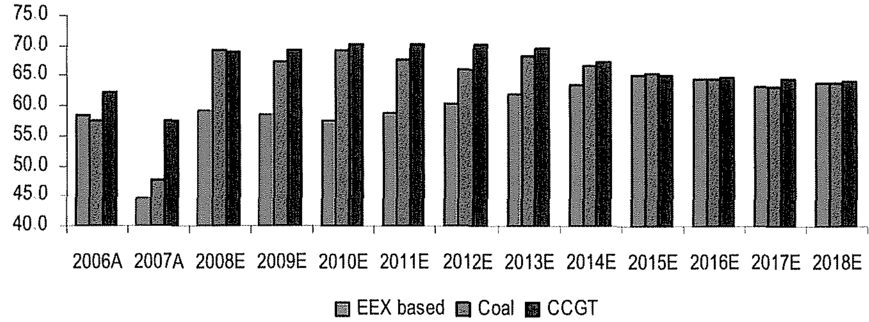
Figure 8: Break-even new entrant gas-fired generating costs - €/MWh



Source: JPMorgan estimates

Our actual forecast is based on (a) the quoted market price near term and (b) a convergence to new entrant prices over a five-year period. We'd see this as being an inherently conservative approach, but probably correct given the current state of forward margins discussed above.

Figure 9: New entrant break-even prices and forecast EEX prices



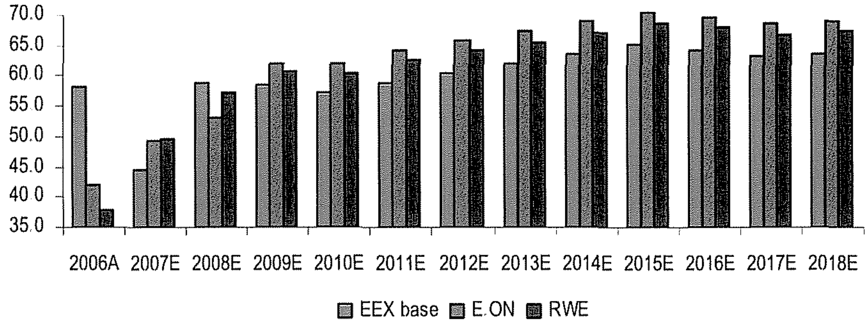
Source: JPMorgan estimates

Achieved prices

The prices actually achieved by the utilities is a function of forward contracting near term and of course the overall "shape" of their production. The forecast above is for the EEX baseload price, and both E.ON and RWE have mid- and peak-load capacity as well. We'd note that historically the peak load price has been around 130% of the baseload price, although the forward curve currently is nearer 140% (as is normally the case during spot-winter months).

As such achieved prices will tend to be below the market price near term (due to earlier contracting) and above longer term (as a result of the "shape" inherent in their generating mix).

Figure 10: Long term power price forecasts - EEX market forecast, and company achieved prices (€/MWh)



Source: JPMorgan estimates.

Impact on our forecasts

RWE, both in absolute and relative terms, gains more from wholesale power price increases, and hence from our change in forecasts. In the table below we show:

- Our old and new forecasts of the impact of moves in wholesale power prices on EBIT, both on an annual and total basis – eg rising power prices lead to an increase in E.ON of €850m in 2007E under our new forecasts, and €2,724m in aggregate over the forecast period.
- The revision in this forecast – eg the impact on E.ON's EBIT from changes in wholesale power prices total €705m over the forecast period.
- The annual growth we forecast in group EBIT from all sources – eg in total we forecast E.ON's EBIT to grow by €7,797m over the forecast period.
- The % of this group growth accounted for by changing wholesale power prices – in E.ON's case this is 35%, and RWE's 44%.

Table 3: Impact of new wholesale power price forecasts on EBIT forecasts

€m	2007E	2008E	2009E	2010E	2011E	2012E	Total
E.ON							
Impact of power price increases on EBIT – Old	792	458	858	-66	-46	23	2,019
Impact of power price increases on EBIT - New	851	436	1,004	9	252	171	2,724
Revision	59	-22	146	75	298	148	705
Annual growth in group EBIT	825	2,080	1,676	1,140	1,077	999	7,797
Impact of higher wholesale as a % of group growth in EBIT	103%	21%	60%	1%	23%	17%	35%
RWE							
Impact of power price increases on EBIT – Old	1,200	853	78	-5	-44	22	2,104
Impact of power price increases on EBIT - New	1,498	1,002	419	-30	224	164	3,276
Revision	299	149	340	-25	268	142	1,172
Annual growth in group EBIT	925	237	688	322	262	256	2,689
Impact of higher wholesale as a % of group growth in EBIT	32%	63%	49%	-8%	102%	55%	44%

Source: JPMorgan estimates.

In aggregate we upgrade our RWE forecast by 26% for 2012E, of which 87% is the result of our higher wholesale power price forecast, and the remaining 13% from the impact of: recovering German supply margins; higher oil prices on RWE DEA and; higher power / gas prices for npower.

Table 4: Revision of RWE earnings forecasts, split into impact from higher wholesale power prices and others

€ m	2007E	2008E	2009E	2010E	2011E	2012E
Old PBT	4,788	5,025	5,224	5,387	5,282	5,199
New PBT	5,099	5,290	5,936	6,195	6,381	6,549
% revision	**6%**	**5%**	**14%**	**15%**	**21%**	**26%**
Revision	311	265	712	808	1,099	1,349
o/w Wholesale power	299	448	788	763	1,031	1,172
% of overall revision	**96%**	**169%**	**111%**	**94%**	**94%**	**87%**
o/w Other	13	-182	-76	45	68	177

Source: JPMorgan estimates.

For E.ON the impact is more modest, with an aggregate 12% upward revision in 2012E PBET, and wholesale power counting for around c44% (we have also revised our Nordic, Southern Europe and UK numbers for the higher power price assumptions and higher German supply margins).

Table 5: Revision of E.ON earnings forecasts, split into impact from higher wholesale power prices and others

€ m	2007E	2008E	2009E	2010E	2011E	2012E
Old PBET	7,996	9,692	10,909	11,664	12,158	12,883
New PBET	7,971	9,725	10,935	11,958	13,147	14,481
% revision	**0%**	**0%**	**0%**	**3%**	**8%**	**12%**
Revision	-26	33	26	294	989	1,598
o/w Wholesale power	59	38	183	258	557	705
% overall revision	**-232%**	**114%**	**719%**	**88%**	**56%**	**44%**
o/w Other	-85	-5	-158	36	433	893

Source: JPMorgan estimates.

Retail & Network pricing in Germany

We see an aggregate downside risk of 3% to our forecasts as a result of ongoing investigations into retail pricing, with potential accelerated price cuts on the launch of incentive regulation in networks quintupling this for RWE and trebling it for E.ON in a worst-case scenario. Whilst both are likely to drag on all year before crystallizing – and perhaps then coming to nothing – we'd stay cautious on German distribution / supply during 2008.

Retail pricing – upgraded forecasts, downside risks

We have so far resisted including retail price increases proposed for January 2008 of 6-10% by the utilities. This has been based on the presumption that the German government – via the competition authorities (BKartA) – would look for a way to mitigate / remove these increases.

Now increasing forecasts by c3%

Given that it appears that the utilities have – at least for now – been able to implement these price increases we are now factoring them into our forecasts. This adds around 3.0% to our group PBT forecasts for both E.ON and RWE.

- For the revenue part of the calculation, we have simply taken the subscriber and pricing data released by the utilities in their price increase press releases. This is multiplied up from monthly data to annual, and multiplied through by subscribers.
- For costs we have considered the potential moves in wholesale prices along with network costs (which have fallen) and moves in taxation. The table below is based on a schematic example historically provided by RWE. The 2008E increase of 6.8% represents the hypothetical impact from RWE's price increases, 8.8% for E.ON's.
- We have factored in: wholesale power price moves consistent with our underlying wholesale power model; changes in renewable energy costs consistent with statements by RWE; % price increases applied to total post tax bills; calculation of sales / marketing revenues (ie supply) as a remainder. As can be seen from the table below, this equates to a doubling to quadrupling of supply margins.

Table 6: Components of a typical German retail power user electricity bill

€/MWh	2003A	2004A	2005A	2006A	2007A	2008E @ 6.8%	2008E @ 8.8%
Wholesale price	29.0	35.0	38.0	42.4	54.8	67.0	67.0
Grid fees	61.0	61.0	68.0	68.0	63.9	62.0	60.1
Sales / Marketing	12.0	12.0	8.0	8.7	3.1	6.5	12.4
Total pre-taxes	**102.0**	**108.0**	**114.0**	**119.1**	**121.8**	**135.4**	**139.5**
Elec Tax	20.5	20.5	20.5	20.5	20.5	20.5	20.5
Concession	17.9	17.9	17.9	17.9	17.9	17.9	17.9
Renewable Energy	4.4	5.4	5.6	6.9	8.0	8.2	8.2
CHP tax	3.1	2.9	3.2	3.4	2.9	2.9	2.9
VAT	23.6	24.8	25.7	26.8	32.5	32.5	32.5
Total	**171.5**	**179.5**	**186.9**	**194.6**	**203.6**	**217.4**	**221.5**

Source: RWE for history, JPMorgan estimates for 2008E

- We apply these higher "costs" to the revenue impact to calculate the profit impact – which is equivalent to the increase in sales/marketing revenues. For both E.ON and RWE this is equivalent to around 3% of our previous 2008E PBT. Whilst RWE is more exposed to German power profits, E.ON's price increases appear to be more ambitious.

Table 7: E.ON - Impact on group profits of higher retail power prices

€m	Subs - m	% price increase	€/month increase	Revenue impact	Profit impact	% '08E PBT
Hanse	0.70	7.1%	4.30	36	10	0.1%
WestfalenWeser	0.75	9.1%	5.35	48	21	0.2%
Bayern	2.10	9.9%	5.60	141	64	0.7%
Thueringer Energie	0.58	4.6%	2.90	20	-1	0.0%
Avacon - Sachsen Anhalt	0.65	8.9%	4.99	39	15	0.2%
Avacon - Niedersachsen	0.65	7.5%	3.94	31	7	0.1%
e.dis	2.10	8.8%	5.87	148	71	0.7%
Mitte	2.00	9.8%	6.40	154	80	0.8%
Total	**9.53**	**8.8%**	**5.39**	**617**	**267**	**2.8%**

Source: Company press releases for price increases, JPMorgan estimates for revenue/profit impact

Table 8: RWE - Impact on group profits of higher retail power prices

€m	Subs - m	Stated % increase	Stated €/month increase	Revenue impact	Profit impact	% '08E PBT
Westfalen-Weser-Ems	5.50	6.6%	4.13	273	71	1.4%
Rhein Ruhr	2.50	6.6%	4.13	124	32	0.6%
Suwag	0.85	9.0%	5.41	55	24	0.5%
Others	0.80	6.8%	4.25	41	11	0.2%
Total	**9.65**	**6.8%**	**4.25**	**492**	**138**	**2.7%**

Source: Company press releases for price increases, JPMorgan estimates for revenue/profit impact

Downside risks however

Our original concerns still apply, however, and if anything have been vindicated.

On Dec 30, 2007 the BKartA confirmed that it is launching an investigative body that will look into the recent prices increases on a "market comparable basis". This will – we understand – utilise an analysis of other competitive markets to determine whether the price increases implemented by the utilities are "fair".

The vehicle that is likely to be used by the BKartA to prosecute a case – should it emerge – is the recently adapted GMB. This competition law adaptation effectively shifts the burden of proof to force the utilities to demonstrate that the moves they have proposed in power prices are justified.

From a timing perspective, we would note comments from the BKartA that suggest this review could take up to a year (or longer) to implement. This would therefore suggest that any downside may take some time to formally crystallise. We would, however, see a continuing flow of negative news-flow, and perhaps even some accounting adjustments intra-year.

Network pricing – Tension could rise again

After several years of delays, the clock is now ticking for the introduction of incentive-based network access pricing in Germany from January 1, 2009. This follows the formal adoption of the legal instruments needed for such regulation on September 21, 2007.

Our initial view – pricing running at flat-nominal

The system to be used will be a hybrid-revenue cap type approach:

- The initial law calls for 2 regulatory periods of 5 years each (ie decisions made in 2008 will be the last, subject to exogenous events) until 2013 for electricity.
- The baseline for each year's tariff will be the previous year, adjusted initially for prevailing consumer price inflation.
- There will be efficiency assumptions at both the industry and individual company levels. The industry factor is to be set at 1.25% per year for the first regulatory period, and 1.5% per year for the second. The individual company factors are set with reference to the most efficient operator within a series of defined company bands, which will be principally be based on scale. We understand that 2006 FY cost bases will be used for the benchmarking.
- A "capex allowance" for reinvestment is set at WACC times 1% of replacement cost value of the asset base. The asset base has yet to be formally defined, but we would look for WACC's on post 2006 assets to continue to be set assuming a 40% equity balance and c7.9% post-tax nominal RoE and for pre-2006 assets to be 6.5% for post-tax nominal RoE allowances.

On the basis of assumptions for consumer prices of 2.0–2.5% and asset values of c1.5x sales (current HCA valuation) it is difficult to see even the most efficient utility making more than +1–1.5% per year in revenues.

The question, then, is what the downside risk to revenues is for the less efficient players. So far we have assumed that this will be relatively limited, and that in general revenues will tend to be flat nominal.

The company specific efficiency factor will be limited so that at most 40% of the distance between the operator and best practice is closed over the first 2 regulatory periods, and then only relating to controllable costs. The table below indicates potential price movements during the first regulatory period, presuming efficiency reductions are applied on a 10 year glide-path basis.

Table 9: Annualised price movements implied by current incentive regulation formulae

Annualised % change	Inefficient	Average	Efficient
Forecast HPIX	+2.50%	+2.50%	+2.50%
Industry Efficiency	-1.25%	-1.25%	-1.25%
Stock specific	-2.49%	-1.10%	+0.00%
Efficiency gap to close	40%	20%	0%
Controllable costs % total	50%	50%	50%
Capex adjustment	+0.12%	+0.12%	+0.12%
Annual adjustment	**-1.12%**	**+0.27%**	**+1.37%**

Source: JPMorgan estimates

Downside case – Cuts sooner, not later

Whilst currently unsubstantiated, we are concerned regarding a suggestion in a press report (*Berliner Zeitung*, December 29, 2007) that the BNetzA may actually implement network fee reductions in the order of 20–25%. It is not clear from the reports whether this relates to (a) an aggregate 10 year cut, (b) an aggregate first phase (ie 5 year), or (c) a one-off cut in 2009.

As a worst case, if it is the latter then we would see cuts for both RWE and E.ON of c€0.8–1.0bn, or 13–15% of RWE's 2009E PBT and 7–9% for E.ON. The impact on valuations from a percentage perspective would be smaller though as such cuts would offset those likely to come later and we'd expect the companies to respond via more rapid / drastic cost cutting.

We would err on the side of optimism for now, and retain our "flat-nominal" forecast, but clearly would see risks from negative sentiment if nothing else in the coming months as the BNetzA makes its pricing decisions.

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Corporate strategy

Reviewing corporate financial strategy, we'd suggest that RWE could announce a 4 year EBIT CAGR target of at least 10%, and up to 18%, with an underlying dividend growth of >13% at its strategy review on February 22. For E.ON we see the group's March 6 report bringing higher capex but formal earnings guidance is unlikely to change.

Balance sheet management

Both E.ON and particularly RWE have significant releveraging potential. We'd be cautious though near term given the potential for high levels of issuance across the sector currently that could create an expensive log-jam. RWE has both the most releveraging potential, but also the most flexibility to be able to wait out the current credit market weakness.

Stated targets and potential for releveraging

Both groups have clearly outlined balance sheet strategies for the coming years, but at this stage it is RWE that has by far the most "unused" potential.

- **E.ON** aims for a 3x "debt factor" (net debt + crystallizing provisions over EBITDA) by 2008E. We would expect this to be carried forward. Even with a €60bn capex plan and 50-60% payout ratio we still see room for significant extra investment / return of value longer term – to the tune of c10% of market cap already by 2010E, rising rapidly as the current capex programme tails off.

Table 10: E.ON funding target & potential

€m	2006A	2007E	2008E	2009E	2010E	2011E	2012E
Adj EBITDA	11,789	12,088	14,851	16,782	18,222	19,530	20,816
Economic Net debt	18,231	21,622	39,407	42,298	44,542	37,281	29,583
Debt factor	1.5	1.8	2.7	2.5	2.4	1.9	1.4
Additional funding at 3x	17,136	14,641	5,145	8,048	10,123	21,311	32,864
% Market Cap	**17.1%**	**15.0%**	**5.6%**	**8.9%**	**11.2%**	**23.7%**	**36.5%**

Source: Company reports, JPMorgan estimates.

- **RWE** has so far stated its net debt target on more of an "absolute" basis, with a stated potential upper (but not target) of €22-24bn. We estimate that the company will be solidly net cash post the American Water disposal. This gives financial flexibility equivalent to c50% of market cap using the €24bn net debt figure, or up to 60% at a 3x ND:EBITDA hurdle. Note here: (a) our capex forecast is c€400m/year below the company target due to the blocking of the Ensdorf coal-plant build, (b) we have not factored the previously discussed share buy-back that would follow an American Water sale, and (c) assets acquired would bring their own EBITDA, potentially giving extra financing capability for subsequent investments.

Table 11: RWE funding target and potential

€m	2006A	2007E	2008E	2009E	2010E	2011E	2012E
EBITDA	7,172	8,525	8,623	9,471	9,936	10,344	10,740
Net debt	6,864	5,656	-1,269	-332	-342	-661	-1,575
ND:EBITDA	1.0	0.7	-0.1	0.0	0.0	-0.1	-0.1
Additional funding at €24bn	17,136	18,344	25,269	24,332	24,342	24,661	25,575
% Market Cap	**30%**	**33%**	**45%**	**43%**	**43%**	**44%**	**45%**
ND:EBITDA	3.3	2.8	2.8	2.5	2.4	2.3	2.2
Additional funding at 3x ND:EBITDA	14,652	19,918	27,139	28,745	30,151	31,694	33,795
% Market Cap	**26%**	**35%**	**48%**	**51%**	**53%**	**56%**	**60%**

Source: Company reports, JPMorgan estimates

Issue of funding aspirations

Whilst easy enough to model in abstract, an actual increase in the indebtedness of the two groups in the magnitudes we are considering is in large part a function of the market's willingness to absorb the bonds / credit lines required to do so.

Our credit analysts estimate that the utilities sector – purely on the basis of debt roll-over, announced capex and M&A and value return – can potentially supply over €64bn of external funding during FY08 alone (see our the JPMorgan Credit research report "*European Utilities in 2008 - Updated supply expectations*", Jan 2, 2008).

Given the current weak conditions in the credit markets – and presuming no material improvement from today's level – we see a real risk of a "log-jam" emerging in the credit market, with the result of widening spreads.

We do not yet see this necessarily as a reason to presume a failure of capex plans / buy-backs in 2008E or beyond, but would caution that any major issuances in the sector will need to be scrutinized carefully from a pricing perspective.

We'd note here that **E.ON's** >€15bn external financing "need" for 2008E would be one of the largest potential corporate issuances since France Telecom's $15bn/€16bn package in March 2001. However, the issuance is probably not needed in its entirety until late 2008E when the recently extended €10bn credit facility expires.

RWE, by contrast, should have a somewhat easier time with the proposed buy-back programme and debt coming due more than covered by organic cash flow and if required non-core disposals.

How to spend it – Asset development

E.ON has outlined a clear 10% operating profit growth target driven by €60bn of capex to 2010E. We believe the profit target can be beaten by 10%, but we are concerned about the delivered returns on recent acquisitions – FY08 results on March 6 will need to allay these.

RWE have not outlined integrated targets yet, but we would look for >10% operating profit growth off of >€25bn capex from the new strategic announcements scheduled for February 22.

E.ON

E.ON has outlined a clear set of capex and earnings targets for 2006A-2010E:

- An overall capex budget of €60bn has been committed to, including €42bn of growth capex (of which €6bn will be spent after 2010E).
- Earnings growth of 10% in EBIT from 2006A to 2010E, or c€4bn increase in EBIT from a variety of sources.

Table 12: Dissection of E.ON's growth plans

€m	Total/2006A	2007E	2008E	2009E	2010E
Total growth	**4,000**	**556**	**1,706**	**706**	**1,031**
1. Growth capex	**925**	**231**	**231**	**231**	**231**
o/w 2007-2009 capex	325	81	81	81	81
o/w New growth capex	600	150	150	150	150
2. Endesa / Viesgo	**1,100**		**1,100**		
3. Efficiency measures	**625**	**108**	**108**	**108**	**300**
o/w 2007-2009 ("Bucket 1")	325	108	108	108	
o/w 2010 ("Bucket 2")	300				300
4. Trading bundling	**400**	**0**	**50**	**150**	**200**
5. Margin improvements	**950**	**217**	**217**	**217**	**300**
o/w 2007-2009 ("Bucket 1")	650	217	217	217	
o/w 2010 ("Bucket 3")	300				300
EBIT	**8,400**	**8,956**	**10,663**	**11,369**	**12,400**

Source: Company statements, JPMorgan estimates

We believe that these targets are inherently conservative, particularly in regards to what can be delivered organically by the Nordic and CEE operations. Backing out developments in wholesale power we see only a 0.5% CAGR implied in all businesses outside Germany.

Table 13: Implied CAGR in non-German wholesale power operations from management targets

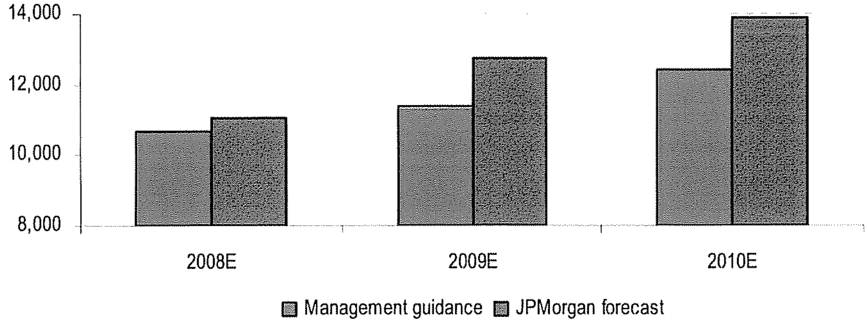
Margin improvements - € m	**950**
o/w Wholesale power in Germany - € m	1955
o/w CO2 costs - € m	-500
o/w Regulation - € m	-600
o/w All other businesses - € m	95
% CAGR of margin improvement	*0.5%*

Source: JPMorgan estimates.

Given we estimate these businesses should be able to deliver >4% we are therefore comfortable with having higher forecasts than management's targets by around 10%. Please see our report "*PERsuing a deeper bucket of growth*", June 15, 2007 for more details.

This does not mean, however, that we should expect an increase in the targets formally at the FY07 results. Experience of the group's 2003–2006 "on.top" strategic capex and earnings plan showed that the originally set targets were beaten significantly. Management targeted EBIT of €6.7bn by2006, and in the end delivered €8.1bn – although this 20% outperformance was accompanied by an acceleration in wholesale power margins.

Figure 11: Potential upside risk vs management targets, €m



Source: JPMorgan estimates, Company data.

We are convinced that E.ON's investments made recently – excluding the E.ON Sverige minorities buy-in – will make the implicit 10% pre-tax RoIC (adjusted for oil taxes in the Skarv-Idun case) by 2012. However, this is somewhat beyond the 3-year commitment made by management.

Table 14: E.ON recent investments RoIC characteristics

€m	2007E	2008E	2009E	2010E	2011E	2012E
EBIT	**116**	**126**	**156**	**600**	**1,098**	**1,391**
Airtricity (US wind)	10	24	53	96	140	164
OGK4 (Russia generation)	80	57	49	438	835	1,105
EnergiE2 (Spain Wind)	26	44	54	65	71	72
Skarv Idun (Norway oil)	0	0	0	0	52	50
Capital employed	**8,711**	**9,545**	**10,400**	**11,255**	**11,910**	**12,566**
Airtricity	1,373	1,754	2,409	3,064	3,720	4,375
OGK4	5,979	6,231	6,231	6,231	6,231	6,231
EnergiE2	722	922	1,122	1,322	1,322	1,322
Skarv Idun	638	638	638	638	638	638
RoIC	**1.3%**	**1.3%**	**1.5%**	**5.3%**	**9.2%**	**11.1%**
Airtricity	0.7%	1.4%	2.2%	3.1%	3.8%	3.8%
OGK4	1.3%	0.9%	0.8%	7.0%	13.4%	17.7%
EnergiE2	3.6%	4.8%	4.8%	4.9%	5.3%	5.4%
Skarv Idun (post tax)	0.0%	0.0%	0.0%	0.0%	8.2%	7.9%
E.ON Sverige	**7.9%**	**10.8%**	**11.9%**	**12.3%**	**13.4%**	**14.5%**

Source: JPMorgan estimates.

As a consequence we will need to see clear evidence from management at the FY07 results on March 6 2008 of delivery on the investment targets to remain confident of our optimistic forecasts.

RWE – Expect operating growth target >10%

RWE has set a broad range of mid-term targets:

- Capex of €5bn per year +/-10% for 2007-2010 covering both acquisitions and mainstream capex, of which 33% (€8.2bn total) is dedicated to growth capex, as opposed to maintenance (€7bn total), regulated grid (€1.4bn) or replacement (€8.4bn). Part of the replacement capex (€1.7bn) will generate cost savings as a result of efficiency improvements.

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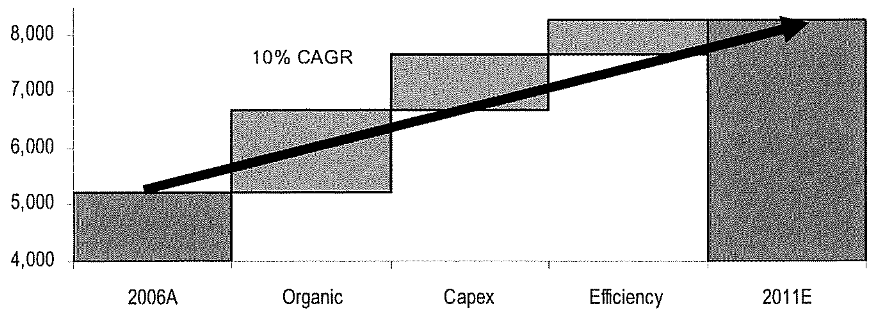
- The growth & efficiency capex (total €9.9bn) is expected to add €1bn to operating result from 2007 to 2011. Further, efficiency measures of €600m realised by 2010E vs 2006A costs are included in group planning.
- Earnings targets of "5% organic growth in operating result medium term", and recurrent net income growth "of at least 10% in 2008" are somewhat vaguer than those given by E.ON, but provide we believe a secure floor.

Given our views on wholesale power prices, the potential from capex and efficiency measures and organic growth we'd see a c10% growth in operating result being possible for RWE out to 2010E.

Figure 12: Implicit RWE Operating Result target, €m



Source: JPMorgan estimates, Company data.

We would expect RWE to significantly extend its targets, both from a capex and earnings perspective at the analyst meeting on February 22. The latter will be a function of the former, if management are confident of their ability to deliver returns of 10%+ as implied by the current plans.

In terms of delivering on capex commitments, all we can say is that the jury is out – the group has not made any acquisitions over €400m since the acquisition of Great Yarmouth Power in late 2005. Indeed, netting disposals off against all capex the group has reduced capital employed by €4.5bn.

Given that this process has raised EVA by €650m (increase in EVA less exogenous factors such as wholesale power price increases), which implies a 14% pre-tax return we would certainly give RWE the initial benefit-of-the-doubt for its reinvestment plans.

Overall, then, we could see a 2006A–2011E EBIT growth commitment of up to 18% (although a figure nearer 13% is more likely). Of course, the likely outcome figures may not necessarily be expressed in these terms.

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Table 15: Potential RWE new operating result targets

€m	Current	Mid case	High case
Capex	**25,000**	**35,000**	**50,000**
o/w Maintenance/Replacement	15,100	15,100	15,100
o/w Growth & Efficiency	9,900	19,900	34,900
EBIT contribution	**1,000**	**2,010**	**3,525**
Organic growth	**1,443**	**1,767**	**2,103**
Growth rate	5%	6%	7%
Efficiency enhancements	**600**	**800**	**1000**
2011E EBIT	8,266	9,800	11,851
% CAGR vs 2006A	**10%**	**13%**	**18%**

Source: JPMorgan estimates.

From a valuation perspective, the table below runs through a hypothetical calculation of how various capex programmes above and beyond the current one (ie €5bn pa) might add to value and earnings.

Table 16: RWE - Hypothetical impact of extra capex programmes above the current €5bn p.a. scheme

€m	Low	Mid	High
Additional Capex	18,344	25,269	33,795
Pre-tax WACC	9%	9%	9%
EVA	0%	1%	2%
EBIT contribution	**1,651**	**2,527**	**3,717**
less Interest cost & tax	-1,073	-1,554	-2,180
Net income contribution	**578**	**973**	**1,538**
EPS contribution	**1.0**	**1.7**	**2.7**
% EPS uplift for 2010E	**14%**	**24%**	**38%**
NPV of EVA & tax shield, per share	0.0	7.5	20.0
NPV of tax shield, per share	7.3	10.1	13.5
% of share price	**8%**	**18%**	**35%**

Source: JPMorgan estimates.

How to spend it – Returning value to shareholders

E.ON is midway through its buyback programme - we would expect neither a cancellation nor extension, and see dividend growth of 15% as sustainable to 2012E. RWE has yet to recommit to a programme of buy-backs, but we would expect a small programme to be launched, along with DPS growth of >13% underlying to be announced.

E.ON

E.ON is currently half way through its €7bn share buy-back programme. Even with our concerns regarding the funding environment we would expect this to be completed, although potentially later rather than earlier in 2008.

On the other side, we would not expect management to extend the programme. As noted above there is potentially €9.4bn of financial headroom by 2010E within the group's 3x debt factor. We'd expect this, though, to be used for an extended capex programme, rather than a buy-back.

The FY07 results on March 6 2008 will also include the group's annual capex budget update, which had been postponed from its usual date in December. We could reasonably expect the capex budget to be upgraded at this time.

From a dividend perspective management are committed to a payout ratio of 50-60% and a dividend growth of 10-20% on average. Our forecast is at the top end of this range, and therefore we do not expect a formal bump in the dividend targets.

RWE

Management had previously committed to a 70-80% payout ratio for 2007E and a buy-back programme of indeterminate size contingent on the successful IPO of a majority in American Water. Following the postponement of the IPO on November 14 these were postponed "to the year of the IPO".

We would not expect management to make any significant changes to dividend policy, but on our raised forecasts we should see a DPS CAGR of 6% on a reported basis, and 13% on an underlying basis vs 2006A.

Table 17: RWE dividend outlook

€ per share	2006A	2007E	2008E	2009E	2010E	CAGR
"Underlying" DPS	2.63	3.01	3.75	4.16	4.34	13.3%
"Special" DPS	0.87	0.00	1.25	0.00	0.00	
Total DPS	**3.50**	**3.01**	**5.00**	**4.16**	**4.34**	**5.5%**
Recurrent EPS	4.38	5.01	6.25	6.94	7.23	13.3%
Payout ratio	80%	60%	80%	60%	60%	
Implied yield	3.6%	3.1%	5.2%	4.3%	4.5%	

Source: JPMorgan estimates, Company data.

As discussed already, RWE has significant free balance sheet capacity to carry out a buy-back programme, as previously committed to. Whether the group continues to follow this course in light of the forthcoming capex programme remains to be seen.

In any event we would expect to see a programme c€4bn (c7% of market cap) given the group's distributable reserves (as defined under German GAAP, commercial balance sheet).

There may be possibilities to boost this either via (a) conversion of retained earnings to distributable reserves or (b) altering consolidation of subsidiaries to move the AG figure closer to the Group consolidated figure under IFRS. However, we would not count on this for now.

Table 18: RWE - Buy-back potential under German GAAP, AG accounts vs Group IFRS accounts

€m	AG GAAP reserves	Group IFRS reserves
2006 y/e Distributable reserves	**2,728**	
*plus 2007 Net income **	3,138	
less 2007 Dividend	-1,690	
2007 y/e Distributable reserves	**4,175**	
% Market Cap	**7.4%**	
Retained earnings	1,968	10,557
% Market Cap	3.6%	19.3%

Source: JPMorgan estimates, Company data. * Using IFRS earnings, which may not reflect GAAP earnings given the latter is based on distributions from subsidiaries rather than consolidated income approach ** Distributable reserves and retained earnings.

E.ON — OW with Dec-08 TP of €173.8

E.ON's strategy and asset base is amongst the most attractive in the sector in our view. We think the market is not yet assigning a full value for this, and with the potential for increased targets on March 6, and an attractive valuation we stay OW despite the negative backdrop from network and retail price reviews in Germany.

Investment stance and key drivers

- **Earnings outlook**: We forecast an 13% EBIT CAGR and 13% RNI CAGR 2011E vs 2006A, with key drivers being wholesale power, corporate rationalization in trading and procurement, growth in East Europe and Nordic markets and reinvestment offset by tightening regulation and CO_2 allocations. Our forecasts are well ahead of the group's stated "10 by 10" plans.
- **Corporate strategy**: By end 2007 E.ON will have the broadest geographic spread of all the European utilities, and is seeking to leverage this through integrated trading and procurement operations and selective (but significant) reinvestments. We have some concerns regarding the timing of returns to be achieved by some parts of the group's €42bn growth capex plan (see p16 for more details), but remain convinced that the plan is significant EVA positive overall.
- **Valuation**: E.ON is trading at a 17% discount to our revised €173.8 end Dec-08 target price (previously €155.4/Dec-08) and looks significantly undervalued on multiples - particularly adjusted for the Gazprom stake at 12.3x 2008E P/E (sector 18.3x). We also find the value return story interesting – with 8% return by end 2008 between the buy-back and dividend plans.
- **Where we are different from consensus**: We are more bullish than both management guidance (12% on 2010E EBIT) and consensus (7% on 2008E EPS). Our target price compares to a Bloomberg consensus average of around €146/share. This stems from our belief that (a) consensus has yet to fully factor E.ON's strategy plan, particularly in regards to the acquisition of assets in Southern Europe and (b) that management have been conservative on organic growth potential, especially in E.Europe and the Nordic markets.
- **Catalysts**: A key fundamental concern at this stage is the reviews by the BKartA into retail power price setting and the BNetzA into 2009-2013 network prices. These are both issues that will unwind through 2008 – we see no major waymarker dates so far. In terms of our "consensus upgrade" story, we'd see management announcements on March 6, and the completion of the asset purchases in southern Europe and Sweden during 1H08 as being key catalysts.

Table 19: E.ON valuation multiples

Dec 31 y/e, ex Gazprom	2007E	2008E	2009E	2010E	2011E
Multiples at €173.5 target price					
P/E *	17.8x	14.9x	13.3x	12.1x	10.9x
Declared Yield	2.6%	3.3%	3.7%	4.4%	4.9%
FCF Adjusted	-3.3%	-19.0%	-1.7%	-0.6%	10.8%
EV/EBITDA	10.6x	9.9x	8.9x	8.3x	7.9x
Multiples at €148.1 share price					
P/E *	14.7x	12.3x	11.1x	10.0x	9.1x
Declared Yield	3.0%	3.7%	4.2%	5.0%	5.5%
FCF Adjusted	-4.0%	-22.8%	-2.0%	-0.8%	13.0%
EV/EBITDA	9.3x	8.8x	8.0x	7.5x	7.1x

Source: JPMorgan estimates. * Adjusted for Gazprom stake.

Table 20: E.ON's key drivers of group profit before exceptionals and tax

€m, Dec 31 y/e	2007E	2008E	2009E	2010E	2011E	2011E vs 2006A
Change in group PBET	902	1,754	1,210	1,023	1,189	6,078
o/w Wholesale power, Germany	895	-203	1,009	14	253	2,601
o/w Regulation, Germany	-334	-227	0	0	0	-561
o/w East Europe (power and gas)	69	350	86	490	505	1,500
o/w Wholesale power, Nordic	410	336	122	46	131	1,044
o/w Interest expense	77	-326	-466	-117	112	-720
o/w Southern Europe	0	1,054	116	93	116	1,170
o/w UK Gentailing margins	44	-50	-98	114	-119	-109
o/w New investments and Others	-259	821	441	383	191	1,153
% change PBET y-o-y	*12.8%*	*22.0%*	*12.4%*	*9.4%*	*9.9%*	*13.0%*

Source: JPMorgan estimates.

Table 21: E.ON's key sensitivities

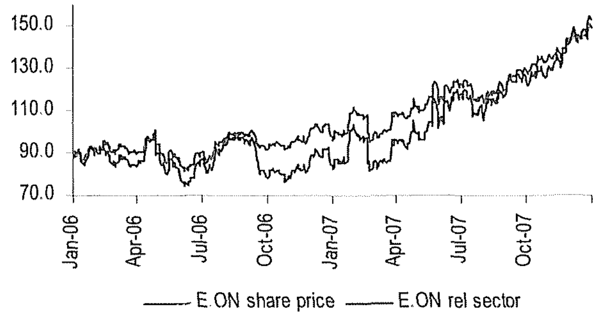
Variable	Our assumption	Flex	PBT effect - €m	S-o-P effect €/share
German electricity				
Network regulation	20% price cut	5% points	187	3.9
Nuclear plant lives	32 years	40 years		3.8
Long term price, Germany	€65.0/MWh	€5/MWh	575	12.0
Other divisions				
Gas network regulation	20% price cut	5% points	43	0.9
Long term price, UK	£39.0/MWh	£3/MWh	154	2.1
UK supply l t EBIT margin	6.5%	100bp	97	1.8
Nordpool price	€55.7/MWh	€5/MWh	165	3.2
Long term price, Italy	€62.6/MWh	€5/MWh	222	2.5
Long term price, Spain	€58.7/MWh	€5/MWh	146	3.1
US return on rate base	9.4%	100bp		1.6
Group	20% price cut	5% points	187	3.9
CO2 price	32 years	40 years		3.8
Average WACC	€65.0/MWh	€5/MWh	575	12.0

Source: JPMorgan estimates.

E.ON has continued to be a strong performer over the past 12 months, with a steady upward climb driven by a mixture of re-rating (shown in Figure 15 below) and high consensus estimates. Whilst the group has well-broken through the 15x FY1 consensus P/E level, we'd see this as sustainable as we believe that the share price is running somewhat ahead of formal consensus forecasts.

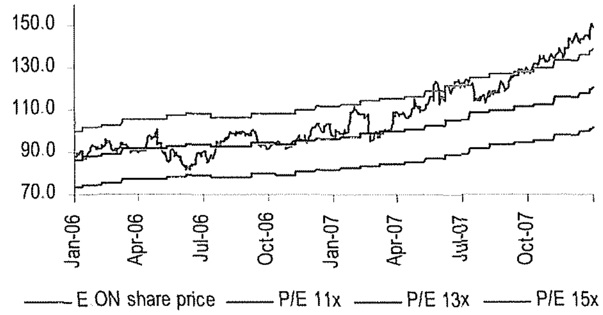
Whilst the share price relative performance looks extreme, and may raise concerns regarding a reversal, we'd note that it is part of a longer term trend of performance since 2002 when E.ON broke away from its conglomerate background and began building its international network of utility assets. We'd therefore see it as an ongoing trend.

Figure 13: E.ON Share Price Performance, €/share, past 2 years



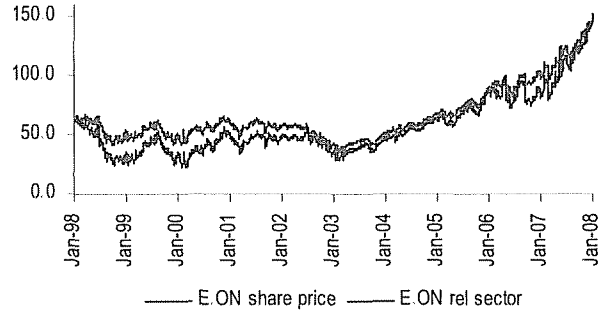
Source: Datastream

Figure 14: E.ON P/E bands, €/share, past 2 years



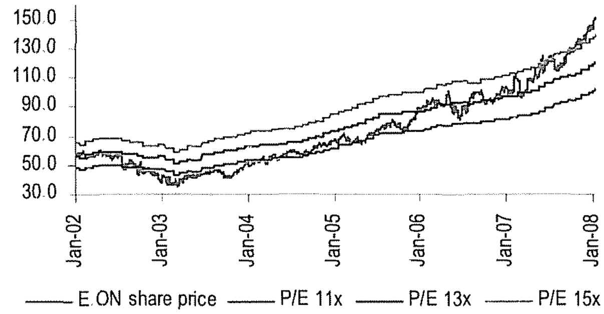
Source: Datastream

Figure 15: E.ON Share Price Performance, €/share, past 10 years



Source: Datastream

Figure 16: E.ON P/E bands, €/share, past 6 years



Source: Datastream

Financials

We have modestly trimmed our near term estimates - principally due to (a) slightly less bullish 2008E contracting than we first expected and (b) weaker SEK/EUR rates – now at SEK10.5/€ vs SEK9.4/€ before. Longer term our forecasts rise due to our higher wholesale power price forecasts commensurate with the move to a $65/bbl fuel-stick.

Table 22: E.ON forecast revisions

€ m	2007E	2008E	2009E	2010E	2011E
Old EBIT	9,007	11,009	12,663	13,536	13,939
New EBIT	8,975	11,055	12,731	13,871	14,948
% Revision	-0.4%	0.4%	0.5%	2.5%	7.2%
Old Adj EPS	7.79	10.09	11.58	12.43	13.00
New Adj EPS	7.78	9.81	11.24	12.41	13.70
% Revision	-0.1%	-2.8%	-2.9%	-0.2%	5.4%
Old DPS	4.40	5.70	6.37	7.46	7.80
New DPS	4.39	5.54	6.18	7.44	8.22
% Revision	-0.1%	-2.8%	-2.9%	-0.2%	5.4%

Source: JPMorgan estimates.

The spread between consensus and our forecasts continues to narrow, with a spread of 7% on 2008E EPS vs 19% in the run up to the 1H07 results in August. We are also below consensus for the first time on the 2007E forecasts. We would expect to see further upgrades in the 2008E/2009E forecasts in consensus as we move into the period ahead of, and immediately after, the March 6 2008 earnings release.

Table 23: Comparison of consensus forecasts for E.ON vs JPMorgan estimates

€ m	2007E	2008E	2009E
Consensus EBIT	8,950	9,975	10,890
JPMe EBIT	8,975	11,055	12,731
% spread	0.3%	10.8%	16.9%
Consensus EPS	8.04	9.14	10.06
JPMe EPS	7.78	9.81	11.24
% spread	-3.2%	7.3%	11.7%
Consensus DPS	3.97	4.62	5.19
JPMe DPS	4.39	5.54	6.18
% spread	10.7%	20.0%	19.1%

Source: JPMorgan estimates, Bloomberg for consensus.

The following tables provide further details of our forecasts for the group.

Table 24: E.ON Contributors to Group EBIT (US GAAP for historicals)

€m, Dec y/e	2005A	2006A	2007E	2008E	2009E	2010E	2011E	5y fcst CAGR
Central Europe	**3,930**	**4,168**	**4,828**	**4,990**	**6,305**	**7,016**	**7,775**	**13.3%**
o/w German Electricity	3,389	3,550	4,240	4,327	5,607	5,880	6,193	11.8%
o/w German Gas	307	272	211	196	204	213	222	-4.0%
o/w East Europe	237	269	298	386	412	838	1,275	36.5%
o/w Other	-3	77	79	81	83	85	87	2.4%
Pan-European Gas	**1,536**	**2,106**	**2,079**	**2,446**	**2,656**	**2,816**	**2,985**	**7.2%**
o/w Up/Midstream	988	1,684	1,477	1,640	1,802	1,906	2,015	3.7%
o/w Downstream	551	431	627	815	868	925	986	18.0%
o/w Industries/Other	-3	-9	-25	-9	-13	-16	-16	12.2%
United Kingdom	**963**	**1,229**	**1,269**	**1,207**	**1,105**	**1,221**	**1,107**	**-2.1%**
o/w Regulated	451	487	483	471	467	469	473	-0.6%
o/w Unregulated	512	742	786	736	638	752	633	-3.1%
Nordic	**806**	**619**	**976**	**1,329**	**1,458**	**1,511**	**1,649**	**21.7%**
o/w Regulated	332	200	610	946	1,067	1,113	1,244	44.1%
o/w Unregulated	474	419	366	383	391	398	406	-0.6%
US Mid West	**365**	**391**	**373**	**380**	**386**	**395**	**403**	**0.6%**
Southern Europe				**1,054**	**1,170**	**1,263**	**1,379**	**-0.2%**
o/w Spain				196	206	281	290	-12.0%
o/w Italy				772	868	834	821	1.9%
o/w France / Other				85	96	148	268	23.7%
Other/Consolidation	**-267**	**-363**	**-550**	**-350**	**-350**	**-350**	**-350**	**-0.7%**
E.ON Group	**7,333**	**8,150**	**8,975**	**11,055**	**12,731**	**13,871**	**14,948**	**12.9%**

Source: JPMorgan estimates, Company data.

Table 25: E.ON Group Profit and Loss Account (US GAAP for historicals)

€m, Dec y/e	2005A	2006A	2007E	2008E	2009E	2010E	2011E	5y fcst CAGR
Revenues, ex taxes	56,399	67,759	59,967	71,497	84,454	91,944	94,560	6.9%
EBITDA	**10,272**	**11,353**	**12,088**	**14,851**	**16,782**	**18,222**	**19,530**	**11.5%**
% change	*-2.7%*	*10.5%*	*6.5%*	*22.9%*	*13.0%*	*8.6%*	*7.2%*	
Depreciation / Amortisation	-2,939	-3,203	-3,113	-3,796	-4,051	-4,351	-4,582	
EBIT	**7,333**	**8,150**	**8,975**	**11,055**	**12,731**	**13,871**	**14,948**	**12.9%**
% change	*-0.4%*	*11.1%*	*10.1%*	*23.2%*	*15.2%*	*9.0%*	*7.8%*	
Financial expenses	-1,027	-1,081	-1,004	-1,330	-1,796	-1,913	-1,801	
PBET	6,306	7,069	7,971	9,725	10,935	11,958	13,147	13.2%
% change	*1.4%*	*12.1%*	*12.8%*	*22.0%*	*12.4%*	*9.4%*	*9.9%*	
Non-operating items	902	-1,936	1,026	0	0	0	0	
o/w Net book gains	491	1,205	990	0	0	0	0	
o/w Restructuring expense	-29	0	0	0	0	0	0	
o/w others	440	-3,141	36	0	0	0	0	
PBT	**7,208**	**5,133**	**8,997**	**9,725**	**10,935**	**11,958**	**13,147**	**20.7%**
Income tax	-2,276	323	-2,326	-2,820	-3,280	-3,587	-3,944	
Minority interests	-553	-526	-639	-922	-983	-1,005	-1,073	
Net income, continuing	4,379	4,930	6,031	5,983	6,671	7,365	8,130	10.5%
Net income, discontinued	3,035	127	0	0	0	0	0	
Reported net income	7,407	5,057	6,031	5,983	6,671	7,365	8,130	10.0%
% change	*70.7%*	*-31.7%*	*19.3%*	*-0.8%*	*11.5%*	*10.4%*	*10.4%*	
Adjusted net income	**3,640**	**4,386**	**5,005**	**5,983**	**6,671**	**7,365**	**8,130**	**13.1%**
% change	*-3.4%*	*20.5%*	*14.1%*	*19.5%*	*11.5%*	*10.4%*	*10.4%*	

Source: JPMorgan estimates, Company data

Table 26: E.ON Group Balance Sheet (US GAAP for historicals)

€m, Dec y/e	2005A	2006A	2007E	2008E	2009E	2010E	2011E	% '07E Equity
Tangible/Intangible assets	45,448	46,447	50,748	69,505	77,578	85,391	83,665	97%
Goodwill	15,363	15,124	15,131	15,302	15,473	15,644	15,815	29%
L.T. financial assets	21,686	34,773	34,773	34,773	34,773	34,773	34,773	66%
Inventories	2,457	3,990	3,531	4,210	4,973	5,414	5,568	7%
Operating receivables	21,354	17,698	16,576	18,236	20,102	21,180	21,557	32%
Cash & securities	15,119	6,187	7,122	5,758	6,235	6,310	10,833	14%
Other assets	5,135	3,013	2,306	2,406	2,531	2,599	2,614	4%
Total assets	**126,562**	**127,232**	**130,187**	**150,191**	**161,664**	**171,311**	**174,825**	**249%**
Shareholders' equity	44,484	47,961	47,047	49,306	55,845	62,060	67,610	90%
Minority interests	4,734	4,917	5,262	5,760	6,291	6,834	7,413	10%
Pension provisions	8,720	3,769	3,396	2,813	2,175	1,490	746	6%
Nuclear provisions	13,362	13,646	13,651	13,656	13,661	13,666	13,671	26%
Financial liabilities	14,362	13,399	18,093	35,093	39,093	42,093	40,093	35%
Other liabilities	40,900	43,540	42,738	43,563	44,600	45,169	45,292	82%
Total equity/liabilities	**126,562**	**127,232**	**130,187**	**150,191**	**161,664**	**171,311**	**174,825**	**249%**
Economic Net Debt	**20,238**	**18,231**	**21,622**	**39,407**	**42,298**	**44,542**	**37,281**	**41%**

Source: JPMorgan estimates, Company data

Table 27: E.ON Group Cash Flow Statement (US GAAP for historicals)

€m, Dec y/e	2005A	2006A	2007E	2008E	2009E	2010E	2011E	5y fcst CAGR
Net income	7,407	5,057	6,031	5,983	6,671	7,365	8,130	
Depreciation etc	3,068	3,751	3,113	3,796	4,051	4,351	4,582	
Net working capital	-1,027	-1,261	779	-1,514	-1,592	-950	-408	
Other non-cash items	-2,847	-353	-700	2,684	3,189	2,577	1,956	
Cash flow from operations	**6,601**	**7,194**	**9,223**	**10,948**	**12,319**	**13,343**	**14,260**	14.7%
Investments	-4,337	-5,161	-7,399	-22,553	-12,123	-12,164	-6,856	5 8%
Disposals	6,599	3,954	0	0	0	0	0	
Others	-1,863	-3,294	0	0	0	0	0	
Cash flow from investments	**399**	**-4,501**	**-7,399**	**-22,553**	**-12,123**	**-12,164**	**-6,856**	
E.ON group dividends	-1,549	-4,614	-2,195	-2,734	-3,266	-3,642	-4,386	-1 0%
Minority dividends	-245	-242	-294	-424	-452	-463	-494	
Others	-4,671	-993	1,600	13,400	4,000	3,000	-2,000	
Cash flow from financing	**-6,465**	**-5,849**	**-889**	**10,242**	**281**	**-1,104**	**-6,880**	
Other items	77	-38	0	0	0	0	0	
Change in cash and securities	612	-3,194	935	-1,363	477	74	523	
Free cash flow (adj)	-770	-2,306	-2,616	-16,377	-995	-22	6,172	

Source: JPMorgan estimates, Company data.

Table 28: E.ON Group per share data and key ratios (US GAAP for historicals)

€m, Dec y/e	2005A	2006A	2007E	2008E	2009E	2010E	2011E	5y fcst CAGR
Shares in issue (avg)	659	659	643	610	594	594	594	
EPS (reported)	**11.24**	**7.67**	**9.38**	**9.81**	**11.24**	**12.41**	**13.70**	12.3%
% change	*70.3%*	*-31.7%*	*22.3%*	*4.6%*	*14.6%*	*10.4%*	*10.4%*	
EPS (adjusted)	5.52	6.65	7.78	9.81	11.24	12.41	13.70	15.5%
% change	*-3.7%*	*20.5%*	*17.0%*	*26.0%*	*14.6%*	*10.4%*	*10.4%*	
DPS declared	**7.00**	**3.35**	**4.39**	**5.54**	**6.18**	**7.44**	**8.22**	**19.7%**
% change	*197.9%*	*-52.1%*	*31.2%*	*26.2%*	*11.5%*	*20.4%*	*10.4%*	
Payout ratio (reported)	**127%**	**50%**	**56%**	**57%**	**55%**	**60%**	**60%**	3 6%
FCFPS (adjusted)	-1.17	-3.50	-4.07	-26.84	-1.68	-0.04	10.40	
RoE (reported)	16.7%	10.5%	12.8%	12.1%	11.9%	11.9%	12.0%	
RoCE (E.ON)	**12.1%**	**13.2%**	**13.9%**	**13.5%**	**14.5%**	**15.3%**	**16.1%**	
Gearing (D/E)	-7.8%	0.5%	7.7%	40.7%	41.7%	41.9%	29.7%	
Gearing (D/CE)	-8.5%	0.5%	7.1%	28.9%	29.4%	29.5%	22.9%	
Gearing (FFO:ND)	32.7%	36.0%	39.5%	26.6%	28.0%	28.8%	36.5%	
Gearing (ND/EBITDA)	**-0.1x**	**0.6x**	**0.9x**	**2.0x**	**2.0x**	**2.0x**	**1.5x**	

Source: JPMorgan estimates, Company data

Valuation and key risks

We have revised our target price from €155.4/share to €173.8/share - the principal drivers of which are: higher wholesale power prices in the Central Europe and Nordic business units; inclusion of OGK-4 in Central Europe International; increased Gazprom share price (now RUB330/share vs RUB270/share before); lower than-expected minority interest cost for the E.ON Sverige buy-out.

Table 29: E.ON - Revision of our target price, €/share sum-of-parts basis

€ per share	Old	New	Change	% Change	% of group change
Central Europe	94.9	104.0	9.0	9%	51%
Germany	75.1	82.5	7.5	10%	42%
International	19.9	21.4	1.5	8%	9%
Pan-European Gas	61.2	67.4	6.1	10%	35%
United Kingdom	23.8	24.1	0.3	1%	2%
Nordic	27.8	30.4	2.6	9%	15%
LG&E	8.4	8.9	0.5	6%	3%
Southern Europe	21.5	22.3	0.8	4%	4%
Enterprise Value	**239.0**	**258.6**	**19.7**	**8%**	**111%**
Net Financial Position	-36.2	-37.7	-1.5	4%	-9%
Provisions	-31.6	-31.6	0.0	0%	0%
Minority Interests	-19.9	-20.2	-0.4	2%	-2%
Equity Value y/e 08	151.3	169.1	17.8	12%	100%
DPS May 07	4.4	4.4	0.0	0%	0%
Target price	**155.7**	**173.5**	**17.8**	**11%**	**100%**

Source: JPMorgan estimates.

We base our €173.8/share formal 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€24/share from the group's Gazprom stake, which contributes little to earnings and (b) the growth potential, returns, and average remaining asset life are all much better for E.ON vs RWE.

Table 30: E.ON sum-of-parts valuation

Division	€ m	€ p.s.	% EV	Comparator	Measure
Central Europe	**61,708**	**104.0**	**40.2%**	**9.4x**	**'08E EBITDA**
Germany	49,001	82.5	31.9%	8.7x	'08E EBITDA
International	12,707	21.4	8.3%	14.1x	'08E EBITDA
Pan-European Gas	39,998	67.4	26.1%	13.0x	'08E EBITDA
Operating Businesses	25,893	43.6	16.9%	9.5x	'08E EBITDA
Gazprom	14,105	23.8	9.2%	2.5%	'08E Income Yield
United Kingdom	**14,327**	**24.1**	**9.3%**	**8.0x**	**'08E EBITDA**
Energy Services	10,216	17.2	6.7%	9.1x	'08E EBITDA
Generation	5,896	9.9	3.8%	445	GBP/kW
Supply	4,320	7.3	2.8%	348	GBP/customer
Central Networks	4,111	6.9	2.7%	1%	Premium to RAV
Nordic	18,048	30.4	11.8%	10.6x	'08E EBITDA
LG&E	5,261	8.9	3.4%	8.7x	'08E EBITDA
Southern Europe	13,217	22.3	8.6%	8.9x	'08E EBITDA
Spain	3,994	6.7	2.6%	12.7x	'08E EBITDA
Italy	6,457	10.9	4.2%	6.6x	'08E EBITDA
Rest of Europe	2,765	4.7	1.8%	13.9x	'08E EBITDA
Corporate Center and assets	973	1.6	0.6%		
Enterprise Value	**153,531**	**258.6**	**100.0%**	**9.4x**	**'08E EBITDA adj**
Net Financial Position	-22,390	-37.7	-14.6%		'08E Book adj
Provisions	-18,771	-31.6	-12.2%		Sum-of-Parts
Nuclear	-13,656	-23.0	-8.9%		'08E Book
Pension	-2,813	-4.7	-1.8%		'08E Book
Mining / Environmental	-2,302	-3.9	-1.5%		'08E Book
Minority Interests	-12,009	-20.2	-7.8%		'08E Adj Book
Equity Value	**100,361**	**169.1**	**65.4%**	**16.8x**	'08E P/E
Target price	**102,969**	**173.5**			Incl '08E payouts

Source: JPMorgan estimates.

- **Financial risks**: Key risks to our valuation are outlined on page 22 above, but 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 recommend 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 €20bn 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 — N with Dec-08 TP of €93.8

RWE has many opportunities given its financial flexibility – we look forward to February 22 as a positive catalyst for the shares with management expected to provide details of future developments and targets. Outside this, though, we think the stock looks fully valued even allowing for a higher power price / margin assumptions.

Investment stance and key drivers

- **Earnings outlook**: Our revised forecasts show a 5 year Operating Income CAGR of 7.4% at the group level, and recurrent net income growth of up to 11.2%. Main earnings drivers are: expanding wholesale margins (€1.82bn including CO_2 costs); €600m of cost cutting; up to €800m from new power plant investments; impact of degearing; with the main offset coming from German network regulation.
- **Corporate strategy**: RWE is currently pursuing a "regular" utility strategy with a focus on cost cutting and reinvestment in new power plant, backed by organic growth from power price increases. We'd expect the strategy announcements due on February 22 to effectively be the same, but writ larger with a 5 year capex programme of up to €50bn and 5 year Operating Result CAGR of 10-18%.
- **Valuation**: RWE is trading at a modest premium to our revised target price, and is trading in line with the sector. Whilst we see upside opportunity from restructuring, we'd argue the asset base as is should trade at a discount given its age and high CO_2 exposure. Put another way - RWE is perhaps a trading Buy, but a fundamental Neutral in the absence of any radical new strategic direction.
- **Where we are different to consensus**: Having upgraded our wholesale power price and retail margin assumptions for Germany our forecasts and target price are essentially in-line with consensus. We'd see the potential for upside to both our and consensus forecasts from strategic developments.
- **Catalysts**: A key fundamental concern at this stage for RWE is the reviews by the BKartA into retail power price setting and the BNetzA into 2009-2013 network prices. RWE is more exposed than E.ON – Germany is around 60% of EV vs 32% for E.ON. However, these are both issues that will unwind through 2008 – we see no major waymarker dates so far. Of more importance near term is the strategic announcements scheduled to be made by management on February 22 2008 discussed above.

Table 31: RWE valuation multiples

Dec 31 y/e	2007E	2008E	2009E	2010E	2011E
Multiples at €94.8 target price					
P/E	18.7x	15.0x	13.5x	13.0x	12.6x
Declared Yield	3.2%	5.3%	4.4%	4.6%	4.8%
FCF Adjusted	2.1%	0.9%	2.1%	3.0%	3.7%
EV/EBITDA	9.2x	8.3x	7.8x	7.5x	7.3x
Multiples at €97.1 share price					
P/E	19.4x	15.5x	14.0x	13.4x	13.0x
Declared Yield	3.1%	5.2%	4.3%	4.5%	4.6%
FCF Adjusted	2.0%	0.9%	2.0%	2.9%	3.6%
EV/EBITDA	9.4x	8.5x	8.0x	7.7x	7.4x

Source: JPMorgan estimates.

Table 32: RWE key earnings drivers

€m, Dec 31 y/e	2007E	2008E	2009E	2010E	2011E	2011E vs 2006A
Change in PBET	**1,656**	**344**	**646**	**259**	**186**	**3,091**
o/w Wholesale power, Germany	691	468	396	40	231	1,826
o/w Degearing	731	107	-42	-63	-76	657
o/w Cost cutting ex water	238	150	175	175	0	738
o/w Power regulation, Germany	-620	-240	0	0	0	-860
o/w UK water	48	43	45	20	11	167
o/w nPower	233	-123	86	23	-29	189
o/w All other factors	336	-61	-14	64	49	373
% ch. PBET y-o-y	*45.4%*	*6.5%*	*11.4%*	*4.1%*	*2.8%*	*13.1%*

Source: JPMorgan estimates

Table 33: RWE group key sensitivities

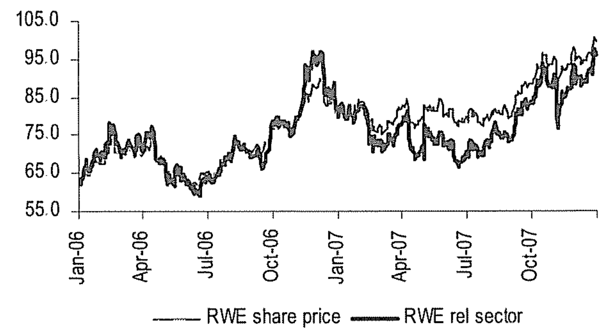
Variable	Our assumption	Flex	PBT effect - €m	S-o-P effect €/share
German electricity				
Oil price, long term	$65/bbl	$5/bbl	429	9.2
Network regulation	25% total cut over 3 years	5% points	172	3.9
Cost cutting	€600m 2006A-2010E	€250m	250	1.2
Nuclear plant lives	32 years	40 years		2.9
Other divisions				
npower l.t. EBIT margin	8.0%	100bp	58	1.1
Group				
CO2	€30/t	€40/t	107	2.2
Average WACC	5.75%	+50bp		-7.5

Source: JPMorgan estimates

RWE shares have strengthened steadily in absolute and relative terms since mid-'07 largely on the back (we believe) of higher commodity prices and optimistic expectations regarding potential strategic changes of direction by the recently appointed CEO Juergen Grossmann. The major reversal in 4Q07 coincided with the decision by RWE management to postpone the sale of its US non-core assets.

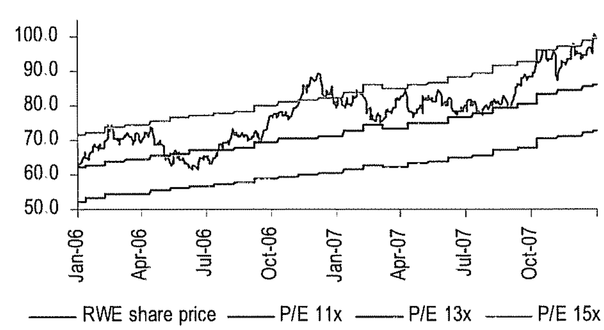
The stock is trading at the top end of its historic P/E band range, though, suggesting that there is some optimism in the shares – but that it is not yet at blue sky levels. Indeed, this is a similar pattern to that demonstrated by E.ON in 1Q07.

Figure 17: RWE share price performance, €/share, last 2 years



Source: Datastream

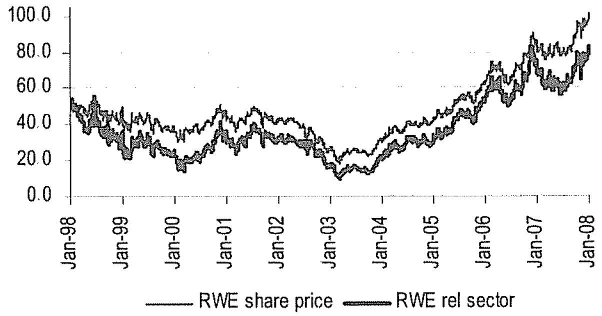
Figure 18: RWE P/E bands analysis, €/share, last 2 years



Source: Datastream

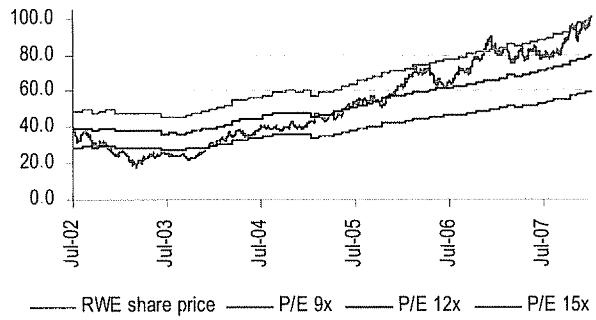
On a longer term vista the group has been a clear trade on the improving power generation margin theme that has been apparent since early 2004. This has been helped by the management moves over the past three years to exit the group's poorly received multi-utility strategy, and hindered somewhat in 2006 and 2007 by RWE's "carbon heavy" generation mix. We'd see the latter as being firmly in the share price now however.

Figure 19: RWE share price performance, €/share, last 10 years



Source: Datastream

Figure 20: RWE P/E bands analysis, €/share, last 6 years



Source: Datastream

Financials

We have revised our forecasts upwards as a result of: higher wholesale power price assumptions, including better-than-expected contracting demonstrated at the 3Q07 results; successful delivery of higher retail power prices in Germany; higher oil price achieved in upstream gas.

Table 34: RWE forecast revisions

€ m	2007E	2008E	2009E	2010E	2011E
Old Operating Profit	6,269	6,613	6,820	7,052	7,026
New Operating Profit	6,606	6,843	7,531	7,853	8,114
% Revision	5.4%	3.5%	10.4%	11.3%	15.5%
Old Adj EPS	5.20	5.96	6.19	6.34	6.22
New Adj EPS	5.01	6.25	6.94	7.23	7.45
% Revision	-3.6%	4.8%	12.1%	14.0%	19.7%
Old DPS	4.16	3.58	3.71	3.81	3.73
New DPS	3.01	5.00	4.16	4.34	4.47
% Revision	-27.7%	39.8%	12.1%	14.0%	19.7%

Source: JPMorgan estimates.

As a consequence, our forecasts are now basically in line with the consensus reported on RWE's website. The only area of discrepancy appears to be on the dividend, where the reported consensus still seems to be factoring in a high payout for 2007E. We'd not see this as significant, and simply a matter of timing of consensus collation by RWE, who use a quarterly gathering timetable.

Table 35: RWE - Consensus vs JPMorgan forecasts

€ m	2007E	2008E	2009E
Consensus Operating Profit	6,927	7,087	7,469
JPMe Operating Profit	6,606	6,843	7,531
% spread	*-4.6%*	*-3.4%*	*0.8%*
Consensus IFRS EPS	5.78	6.51	6.97
JPMe IFRS EPS	5.01	6.25	6.94
% spread	*-13.3%*	*-3.9%*	*-0.5%*
Consensus DPS	4.05	3.76	4.00
JPMe DPS	3.01	5.00	4.16
% spread	*-25.8%*	*33.1%*	*4.1%*

Source: Bloomberg for consensus, JPMorgan estimates

The following tables detail our forecasts for the group.

Table 36: RWE - Contributors to group operating result

€m, Dec y/e	2005A	2006A	2007E	2008E	2009E	2010E	2011E	5y fcst CAGR
RWE Power	**2,112**	**2,744**	**3,316**	**3,967**	**4,374**	**4,478**	**4,695**	**11.3%**
Power Generation	1,667	2,132	2,833	3,297	3,680	3,706	3,870	12.7%
RWE DEA	445	612	483	670	694	772	824	6.1%
RWE Energy	**2,507**	**2,506**	**2,252**	**2,404**	**2,599**	**2,795**	**2,869**	**2.7%**
German Regions	1,609	1,427	1,135	1,180	1,352	1,526	1,575	2.0%
International Regions	381	403	484	608	630	654	680	11.0%
E&G Transmission	452	761	642	624	621	619	616	-4.1%
Other	65	-85	-9	-7	-5	-3	-1	-56.9%
RWE npower	**437**	**512**	**745**	**621**	**707**	**730**	**701**	**6.5%**
Other	315	-81	293	-150	-150	-150	-150	
RWE Group	**5,371**	**5,681**	**6,606**	**6,843**	**7,531**	**7,853**	**8,114**	**7.4%**

Source: JPMorgan estimates, Company data.

Table 37: RWE Group Profit and Loss Account

€m, Dec y/e	2005A	2006A	2007E	2008E	2009E	2010E	2011E	5y fcst CAGR
Revenues ex tax	40,518	42,871	43,590	45,211	45,430	45,924	46,382	1.6%
EBITDA	**8,324**	**7,172**	**8,525**	**8,623**	**9,471**	**9,936**	**10,344**	**7.6%**
% change		*-13.8%*	*18.9%*	*1.2%*	*9.8%*	*4.9%*	*4.1%*	
Depreciation and amortisation	2,953	1,491	1,918	1,781	1,941	2,083	2,230	8.4%
Operating result	**5,371**	**5,681**	**6,606**	**6,843**	**7,531**	**7,853**	**8,114**	**7.4%**
% change		*5.8%*	*16.3%*	*3.6%*	*10.1%*	*4.3%*	*3.3%*	
Non-operating result	142	11	-203	-356	-356	-356	-356	
Financial result	-1,817	-2,035	-1,304	-1,197	-1,239	-1,302	-1,378	-7.5%
Income before tax	**3,696**	**3,657**	**5,099**	**5,290**	**5,936**	**6,195**	**6,381**	**11.8%**
% change		*-1.1%*	*39.4%*	*3.7%*	*12.2%*	*4.4%*	*3.0%*	
Taxes on income	-1,221	-982	-1,812	-1,845	-2,092	-2,175	-2,234	
Minority interests	-224	1,172	-149	-159	-172	-185	-190	
Reported net income	**2,251**	**3,847**	**3,138**	**3,286**	**3,672**	**3,836**	**3,957**	**0.6%**
% change		*70.9%*	*-18.4%*	*4.7%*	*11.7%*	*4.5%*	*3.2%*	
Adj net income	2,257	2,466	2,817	3,517	3,902	4,067	4,189	11.2%
% change		*9.3%*	*14.3%*	*24.8%*	*10.9%*	*4.2%*	*3.0%*	

Source: JPMorgan estimates, Company data.

Table 38: RWE Group Balance Sheet

€m, Dec y/e	2005A	2006A	2007E	2008E	2009E	2010E	2011E	% 07E Equity
Tangible/Intangible assets	39,611	29,022	30,634	25,861	28,431	30,645	32,578	197%
Goodwill	14,169	12,138	12,138	12,138	12,138	12,138	12,138	78%
L.T. financial assets	12,674	7,221	7,221	7,221	7,221	7,221	7,221	46%
Inventories	2,257	2,226	2,263	2,347	2,359	2,385	2,408	15%
Operating receivables	8,325	8,876	9,025	9,360	9,406	9,508	9,603	58%
Cash and securities	11,775	19,582	14,085	22,475	23,022	24,541	26,395	90%
Other assets	19,311	14,223	14,149	14,036	13,932	13,815	13,687	91%
Total assets	**108,122**	**93,288**	**89,514**	**93,440**	**96,509**	**100,252**	**104,031**	**575%**
Shareholders' equity	11,474	13,439	14,967	16,375	17,078	18,385	19,680	96%
Minority interests	1,643	672	614	614	614	614	614	4%
Pension provisions	11,997	11,584	3,675	3,641	3,626	3,633	3,669	24%
Nuclear provisions	8,675	8,834	9,127	9,628	10,155	10,712	11,299	59%
Financial liabilities	27,828	19,382	20,585	22,085	23,585	25,085	26,585	132%
Other liabilities	46,505	39,377	40,546	41,097	41,451	41,823	42,183	260%
Total equity/liabilities	**108,122**	**93,288**	**89,514**	**93,440**	**96,509**	**100,252**	**104,031**	**575%**
Net financial debt	**11,438**	**6,864**	**5,656**	**-1,269**	**-332**	**-342**	**-661**	**36%**

Source: JPMorgan estimates, Company data.

Table 39: RWE Group Cash Flow Statement

€m, Dec y/e	2005A	2006A	2007E	2008E	2009E	2010E	2011E	5y fcst CAGR
Net income	2,475	2,675	3,287	3,445	3,844	4,021	4,147	9.2%
Depreciation etc	3,795	3,025	2,555	2,413	2,587	2,744	2,906	
Net working capital	72	131	-314	-36	-201	-121	-107	
Other non-cash items	-1,038	952	1,072	287	685	585	610	
Cash flow from operations	**5,304**	**6,783**	**6,600**	**6,108**	**6,915**	**7,228**	**7,557**	**2.2%**
Investments	-4,138	-4,728	-4,605	-4,778	-4,895	-4,697	-4,577	
Disposals	832	7,854	700	7,400	0	0	0	
Others	1,257	-5,597	0	0	0	0	0	
Cash flow from investments	**-2,049**	**-2,471**	**-3,905**	**2,622**	**-4,895**	**-4,697**	**-4,577**	**13.1%**
RWE group dividends	-844	-984	-1,968	-1,690	-2,814	-2,341	-2,440	19.9%
Minority dividends	-226	-224	-224	-149	-159	-172	-185	-3.7%
Others	-2,314	-1,740	1,000	1,500	1,500	1,500	1,500	
Cash flow from financing	**-3,384**	**-2,948**	**-1,192**	**-340**	**-1,473**	**-1,013**	**-1,125**	
Other items	34	-1	0	0	0	0	0	
Change in cash and securities	**-95**	**1,363**	**1,503**	**8,391**	**547**	**1,519**	**1,854**	
Free cash flow (adj)	1,315	895	1,101	468	1,108	1,565	1,952	16.9%

Source: JPMorgan estimates, Company data.

Table 40: RWE Group Per Share Data and Key Ratios

€m, Dec y/e	2005A	2006A	2007E	2008E	2009E	2010E	2011E	5y fcst CAGR
Shares in issue (avg)	562.4	562.4	562.4	562.4	562.4	562.4	562.4	
EPS (reported)	**4.00**	**6.84**	**5.58**	**5.84**	**6.53**	**6.82**	**7.04**	**0.6%**
% change		70.9%	-18.4%	4.7%	11.7%	4.5%	3.2%	
EPS (adjusted)	4.01	4.38	5.01	6.25	6.94	7.23	7.45	11.2%
% change		9.3%	14.3%	24.8%	10.9%	4.2%	3.0%	
DPS declared	**1.75**	**3.50**	**3.01**	**5.00**	**4.16**	**4.34**	**4.47**	**5.0%**
% change		100.0%	-14.1%	66.5%	-16.8%	4.2%	3.0%	
Payout ratio (reported)	**43.7%**	**51.2%**	**53.9%**	**85.6%**	**63.8%**	**63.6%**	**63.5%**	
FCFPS (adjusted)	2.34	1.59	1.96	0.83	1.97	2.78	3.47	16.9%
RoE (reported)	19.6%	28.6%	21.0%	20.1%	21.5%	20.9%	20.1%	
RoCE (RWE)	**12.7%**	**17.3%**	**19.2%**	**23.3%**	**28.4%**	**27.5%**	**26.8%**	
Gearing (D/E)	87%	49%	36%	-7%	-2%	-2%	-3%	
Gearing (D/CE)	47%	33%	27%	-8%	-2%	-2%	-3%	
Gearing (ND/EBITDA)	**137%**	**96%**	**66%**	**-15%**	**-4%**	**-3%**	**-6%**	

Source: JPMorgan estimates, Company data.

Valuation and key risks

We base our €93.8 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 41: RWE Group DCF-based sum-of-parts analysis

Division	€ m	€ p.s.	% EV	Comparator	Measure
Power	34,795	61.9	49.6%	7.4x	08E EBITDA
Generation	29,932	53.2	42.7%	7.8x	08E EBITDA
RWE DEA	4,863	8.6	6.9%	5.4x	08E EBITDA
Energy	25,930	46.1	37.0%	8.2x	08E EBITDA
Germany inc Solutions	12,654	22.5	18.0%	7.2x	08E EBITDA
International	6,177	11.0	8.8%	11.0x	08E EBITDA
Transmission Networks	7,099	12.6	10.1%	8.5x	08E EBITDA
npower	8,723	15.5	12.4%	9.8x	08E EBITDA
Generation	5,064	9.0	7.2%	386	GBP/kW
Supply	3,659	6.5	5.2%	390	GBP/Customer
Financial holdings	705	1.3	1.0%		
Enterprise Value	**70,153**	**124.7**	**100.0%**	**8.1x**	08E EBITDA
Net Debt	1,269	2.3	1.8%		
Provisions	-16,851	-30.0	-24.0%		
Nuclear	-9,628	-17.1	-13.7%		
Mining / Environmental etc	-7,224	-12.8	-10.3%		
Minority Interests	-3,488	-6.2	-5.0%	**21.9x**	08E P/E equiv
Equity Value	**51,083**	**90.8**	**72.8%**	**14.5x**	08E P/E equiv
Equity Value with May 2008 dividend	**52,773**	**93.8**		**15.0x**	08E P/E equiv

Source: JPMorgan estimates.

- **Financial risks**: Table 32 and Table 33 on page 30 illustrate the key drivers of our earnings forecasts and sensitivities to valuation. Key amongst these 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; significant buy back programme (we factor nothing in our forecasts); an extension of group cost cutting programmes; aggressive, capex or acquisition-led growth.
- **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.

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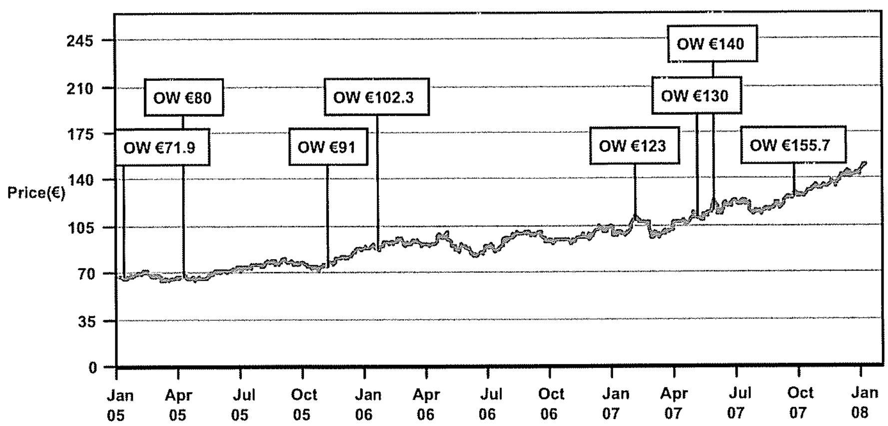
Important Disclosures

- **Market Maker/ Liquidity Provider:** JPMSL and/or an affiliate is a market maker and/or liquidity provider in E.ON, RWE.
- **Lead or Co-manager:** JPMSI or its affiliates acted as lead or co-manager in a public offering of equity and/or debt securities for E.ON within the past 12 months.
- **Beneficial Ownership (1% or more):** JPMSI or its affiliates beneficially own 1% or more of a class of common equity securities of E.ON, RWE.
- **Client of the Firm:** E.ON is or was in the past 12 months a client of JPMSI; during the past 12 months, JPMSI provided to the company investment banking services, non-investment banking securities-related service and non-securities-related services. RWE is or was in the past 12 months a client of JPMSI; during the past 12 months, JPMSI provided to the company investment banking services, non-investment banking securities-related service and non-securities-related services.
- **Investment Banking (past 12 months):** JPMSI or its affiliates received in the past 12 months compensation for investment banking services from E.ON, RWE.
- **Investment Banking (next 3 months):** JPMSI or its affiliates expect to receive, or intend to seek, compensation for investment banking services in the next three months from E.ON, RWE.
- **Non-Investment Banking Compensation:** JPMSI has received compensation in the past 12 months for products or services other than investment banking from E.ON, RWE. An affiliate of JPMSI has received compensation in the past 12 months for products or services other than investment banking from E.ON, RWE.

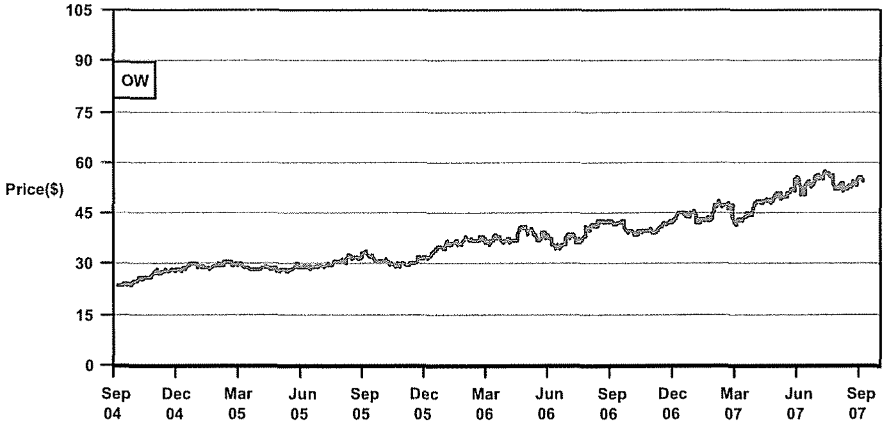
E.ON (EONG.DE) Price Chart



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	88.48	102.30
05-Feb-07	OW	109.43	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

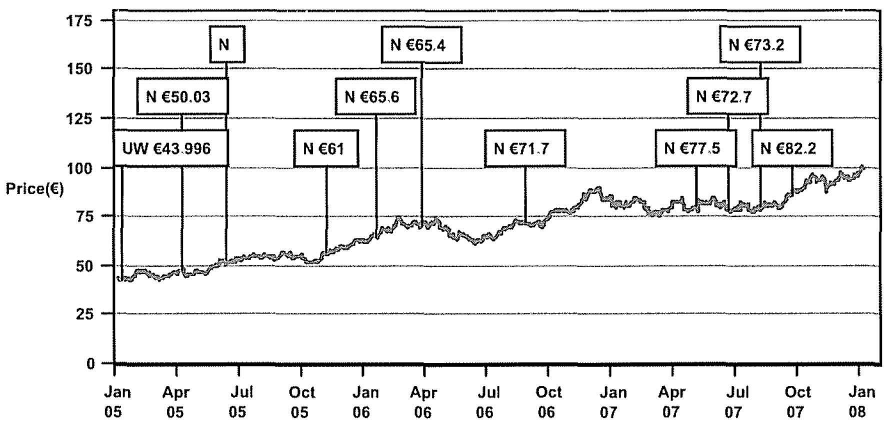
Source: Reuters and JPMorgan; price data adjusted for stock splits and dividends.
This chart shows JPMorgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
JPMorgan ratings: OW = Overweight, N = Neutral, UW = Underweight

E.ON (EON) Price Chart



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 (€)
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	64.95	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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JPMorgan uses the following rating system: **Overweight** [Over the next six to twelve months, we expect this stock will outperform the average total return of the stocks in the analyst's (or the analyst's team's) coverage universe.] **Neutral** [Over the next six to twelve months, we expect this stock will perform in line with the average total return of the stocks in the analyst's (or the analyst's team's) coverage universe.] **Underweight** [Over the next six to twelve months, we expect this stock will underperform the average total return of the stocks in the analyst's (or the analyst's team's) coverage universe.] The analyst or analyst's team's coverage universe is the sector and/or country shown on the cover of each publication. See below for the specific stocks in the certifying analyst(s) coverage universe.

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JPMorgan Equity Research Ratings Distribution, as of December 31, 2007

	Overweight (buy)	Neutral (hold)	Underweight (sell)
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IB clients*	50%	51%	38%
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IB clients*	71%	64%	49%

*Percentage of investment banking clients in each rating category.
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Valuation snapshots for RWE and E.ON

Table 42: RWE valuation snapshot at Jan 10, 2008 close prices

Sum of Parts, y/e '08E	**€m**	**€p.s.**	**% EV**	**'08E EV/EBITDA**
Power	34,795	61.9	50%	8.7x
Energy	25,930	46.1	37%	8.8x
nPower	8,723	15.5	12%	9.0x
Other	705	1.3	1%	
Enterprise value	**70,153**	**124.7**	**100%**	**8.2x**
less: Net debt	1,269	2.3	2%	0.1x
less: Provisions/other	-20,340	-36.2	-29%	
Equity Value inc distributions	**52,773**	**93.8**	75%	
Dec 31 y/e	***2007E***	***2008E***	***2009E***	***2010E***
Multiples at €93.8 target price				
P/E	18.7x	15.0x	13.5x	13.0x
Declared Yield	3.2%	5.3%	4.4%	4.6%
FCF Adjusted	2.1%	0.9%	2.1%	3.0%
EV/EBITDA	9.2x	8.3x	7.8x	7.5x
Multiples at €97.1 share price				
P/E	19.4x	15.5x	14.0x	13.4x
Declared Yield	3.1%	5.2%	4.3%	4.5%
FCF Adjusted	2.0%	0.9%	2.0%	2.9%
EV/EBITDA	9.4x	8.5x	8.0x	7.7x

Source: JPMorgan estimates.

Table 43: E.ON valuation snapshot at Jan 10, 2008 close prices

Sum of Parts, y/e '08E	**€m**	**€p.s.**	**% EV**	**'08E EV/EBITDA**
Central Europe	61,708	104.0	40%	9.4x
Pan-Euro Gas	39,998	67.4	26%	13.0x
UK	14,327	24.1	9%	8.0x
Nordic	18,048	30.4	12%	10.6x
US Mid-West	5,261	8.9	3%	8.7x
Southern Europe	13,217	22.3	9%	8.9x
Corporate Center	973	1.6	1%	
Enterprise value	**153,531**	**258.6**	**100%**	**10.3x**
less: Net debt	-22,390	-37.7	-15%	-1.5x
less: Provisions/other	-30,780	-51.9	-20%	
Equity Value incl distributions	**102,969**	**173.5**	**67%**	
Dec 31 y/e, ex Gazprom	**2007E**	**2008E**	**2009E**	**2010E**
Multiples at €173.5 target price				
P/E	17.8x	14.9x	13.3x	12.1x
Declared Yield	2.6%	3.3%	3.7%	4.4%
FCF Adjusted	-3.3%	-19.0%	-1.7%	-0.6%
EV/EBITDA	10.6x	9.9x	8.9x	8.3x
Multiples at €148.1 share price				
P/E	14.7x	12.3x	11.1x	10.0x
Declared Yield	3.0%	3.7%	4.2%	5.0%
FCF Adjusted	-4.0%	-22.8%	-2.0%	-0.8%
EV/EBITDA	9.3x	8.8x	8.0x	7.5x

Source: JPMorgan estimates.

Electric Utilities

E.ON

Improved valuation of a truly integrated gas business

Buy (12m)

Price 14/01/08	12m target
€145.0	€164.0

Sector Weighting
Overweight

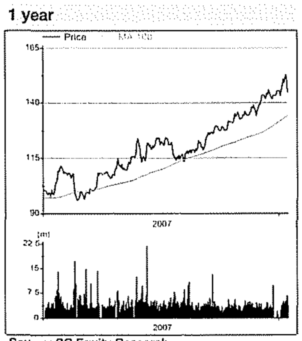
Preferred stock
EDF

Least preferred stock
Centrica

Type of investment

Share buyback	✓
Value	✓
Corporate action	✓

1 year



Source: SG Equity Research

- **Update** SG's Commodities team forecast that coal and oil prices will remain higher for longer (oil at an average of $80/b and coal at $90/t in 08), providing support for high utilities valuations. We expect E.ON to announce asset swaps with Gazprom in the first quarter, which should allow E.ON to go a long way towards resolving the problem of its lack of upstream hedge whilst adding indirect upstream integration to its Russian power business. We believe that E.ON, having agreed to walk away from Endesa, is in a strong bargaining position vis-à-vis Enel to acquire solid positions in Italy and Spain (i.e. countries offering better organic growth than E.ON's main existing markets). E.ON plans to continue its share buy-back programme over the next six months (c.0.2m shares/day on average).
- **Impact** In the current environment of nervous stock markets and high energy prices, we continue to regard E.ON as the reference utility investment in view of: (i) the pro-active nature of management, which has carried out a series of well-received transactions (acquisitions and swaps), since unveiling its new strategy in May 2007, and which we expect to continue in the same vein, (ii) the group's defensive qualities, evidenced by its true European footprint as well as the balance it has struck between electricity/gas, wholesale/retail, clean/thermal generation, regulated/competitive, and (iii) the benefit for E.ON of high energy prices given a tight supply-demand equilibrium across Europe and its advantages of scale when pricing new investments in generation.
- **Target price & rating** Buy maintained, target raised from €150 to €164, based on a DCF (€163, 6.6% WACC, 1% growth to perpetuity, 19.5% norm. EBITDA margin, benefit from base-year switch to 2008), a sum-of-parts (€164) for which we have upgraded the value of E.ON's gas activities (now valued at the equivalent of 7.9x 2008e EV/EBITDA, still a discount to closest peers on an average c.8.5x), its shareholding in Gazprom and its Nordic activities.
- **Next events & catalysts** E.ON is taking part in our Utilities conference in Paris on 17 January 2008. It will present its European trading activities in February. This should provide details on the efficiencies realised through the amalgamation of all the European trading subsidiaries, including Nordic, under a single umbrella in Dusseldorf.

E.ON
on www.sgresearch.socgen.com

Share data			
RIC EONG.DE, **Bloom** EOA GR			
52-week range			152.8-96.1
EV 07 (€m)			117,838
Market cap. (€m)			100,368
Free float (%)			95.3
Performance (%)	**1m**	**3m**	**12m**
Ordinary shares	-0.7	13.4	44.1
Rel. Eurofirst 300	5.1	26.8	52.0

Financial data	12/06	12/07e	12/08e	12/09e
Revenues (€bn)	64.09	69.11	81.23	85.05
EBIT margin (%)	13.0	13.3	12.9	13.3
Rep. net inc. (€bn)	*5.31*	*5.53*	*6.13*	*6.84*
EPS (adj.) (€)	7.10	8.10	9.29	10.66
Dividend/share (€)	3.35	4.10	5.00	6.00
Payout (%)	88.6	40.0	42.8	45.2
Interest cover (x)	12.5	16.1	7.6	7.8
Net debt/equity (%)	nm	16.5	51.8	49.3

Ratios	12/06	12/07e	12/08e	12/09e
P/E (x)	20.4	17.9	15.6	13.6
FCF yield (/EV) (%)	15.8	3.1	2.0	2.0
Dividend yield (%)	2.3	2.8	3.4	4.1
Price/book value (x)	2.1	2.0	2.0	1.8
EV/revenues (x)	1.83	1.71	1.62	1.55
EV/EBIT (x)	14.0	12.8	12.5	11.7
EV/IC (x)	1.9	1.7	1.6	1.5
ROIC/WACC (x)	1.3	1.5	1.5	1.5

CAGR 06-09e: +14.5%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We raise our sum-of-parts to €164 from €150

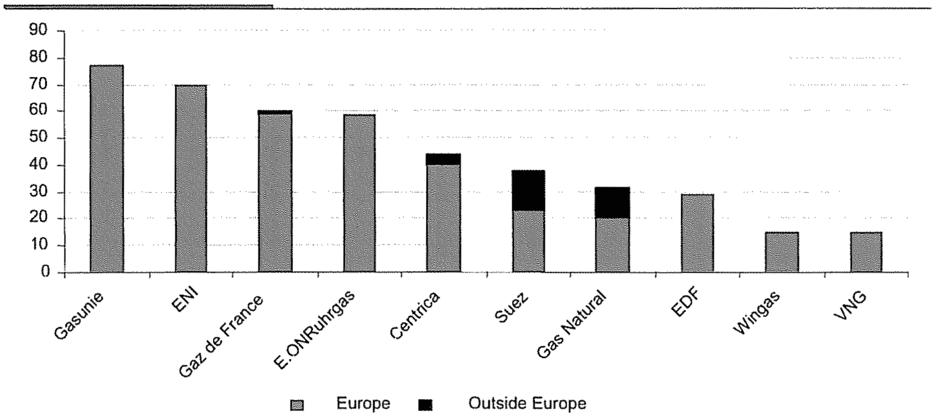
We remain at Buy on E.ON and have upgraded our sum-of-parts to take account of the following elements:

- Rise in valuation of E.ON's Nordic activities to reflect Fortum's multiples (+40% since the start of 2007) and those implied in the Statkraft asset swap in Q4 2007 (average historic EV/EBITDA: 12x): **€4 per share.**
- Rise in valuation of Russian assets: we take 100% of the value of OGK-4 versus 75% previously and reflect the strength in the Gazprom share price (E.ON stake: 6.4%): **€4 per share.**
- Rise in the value of E.ON's operating assets in gas, with a strategic valuation being attached to the group's positions in upstream, storage and networks: **€9 per share.**
- Inclusion of future Gazprom minority interests to be taken in E.ON's central and western European power and gas assets as part of the Yuzhno Russkoye swap: **-€3 per share.**

Upgrading E.ON's gas business from €27bn to €32bn

At SG Equity Research's Premium Review in Paris last December, E.ON indicated that if there were a single area not fully appreciated by the market, it was the company's gas business, E.ON-Ruhrgas. We now value E.ON's Pan-European gas division, plus the gas customers contained within E.ON's Central Europe division (but excluding the market value of the Gazprom shareholding), at an EV of €32bn, or 26% of E.ON's gross sum-of-parts, up from €27bn. This compares with Gaz de France's EV of around €45bn, Gaz de France enjoying a stronger position than E.ON-Ruhrgas in its home market, more diversified sources of gas, a more developed upstream and LNG business and final volumes just above those of E.ON Ruhrgas.

Gas volume sold in 2006 (BCM)



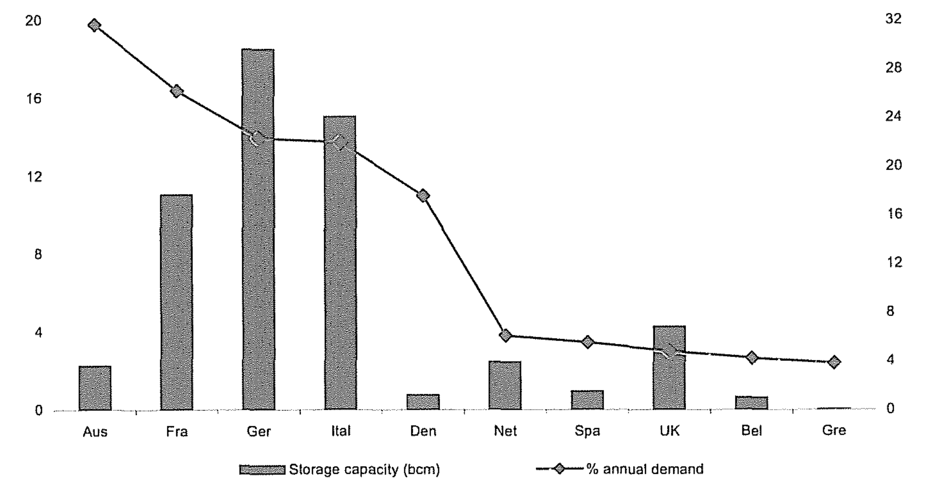
Source: SG Equity Research/Suez

E.ON's gas strategy: long-term security, improved integration, improved diversity

E.ON's efforts are centred on developing its gas business in the following ways:

- Long-term security of supply, through long-term import contracts, regardless of the EU's view that such contracts are anti-competitive: E.ON has concluded import contracts with Gazprom through 2038.
- Improving the level of upstream hedge through an increase in equity gas production (we examine this in more detail below).
- Participating in the construction of new gas infrastructure: both import (24.5% stake in the NordStream pipeline bringing Russian gas to Germany from 2010 via the Baltic, cutting out the ex-CIS states and Poland) and storage (the Etzel storage facility in northern Germany being the main project as E.ON looks to double its capacity to 9.5-11.5BCM by 2015).

Main storage in Europe



Source: SG Equity Research

- Expanding into LNG (with projects to open equity re-gas capacity of at least 15BCM in Germany, Italy, France, Croatia).

Yuzhno Russkoye, a favourable conclusion of negotiations appears imminent

The major decision to be made in the near term concerns the giant gas field Yuzhno Rosskoye. It appears that negotiations are progressing towards a conclusion and that the benefits for both E.ON and Gazprom are too great to allow failure. We believe that this will be a crucial step for E.ON in gaining a sufficiently-integrated gas business.

E.ON cannot solve its inadequate upstream hedge without Yuzhno Russkoye

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 the late-2005 acquisition of Caledonian 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 acquired a 28% stake in the Skarv and Idun fields for €0.7bn with €1.0bn in further development costs, bringing over 1BCM per year from 2012.

Altogether, these projects should bring annual output to around 3.5BCM, or 6% of 2006 gas needs. This compares with RWE at 20%, Centrica at 14% and Gaz de France at 10%.

E.ON needs Yuzhno Russkoye to avoid the need for expensive acquisitions

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 virtually up to its target of 10BCM in annual upstream output.

By concluding this deal, E.ON's self-sufficiency could (if we assume a 25% stake) increase from 6% to 16%. 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 the extension and increase of contracts with Gazprom concluded in August 2006. However, given Europe's dependence on Russia as an energy supplier and E.ON's status as leading foreign shareholder in Gazprom, does this really matter?

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	1.7	2.8	2.4
Skarv + Idun, from 2012	1.4	2.4	3.4
Yuzhno Russkoye 25% interest	6.2	10.3	8.9
E.ON's upstream gas hedge	9.7	16.2	13.9

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. Based on a long-term assumption of $60/boe (our current view), a 25% stake in Yuzhno-Russkoye could be worth $11bn, or €8.5bn.

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. This is understandable in our view, and E.ON has not been complaining: indeed, it has been at pains to talk up: (i) its long-term aim of strengthening its relationship with Gazprom, and (ii) emphasise that, in its view, the EU, not Russia, presents a danger to EU supplies given the organisation's plans to abolish long-term gas contracts, unbundled network ownership, etc.

E.ON has every reason to seek a successful conclusion...

E.ON said on 17 December 2007 that it had achieved "major progress in negotiations", notably in the identification of power plants "in various western and central European countries" and gas storage facilities in which Gazprom will take a stake.

For E.ON, the value in the successful termination of these negotiations comes in several forms:

- It resolves its upstream hedge problem in one fell swoop, taking a stake in a hugely valuable field that has just come on stream and will see plateau production by 2012 at 25BCM.
- It cements its industrial relationship with Gazprom (likely co-ordination in power sales and gas storage), raising E.ON's outlook for security of gas supply (recalling that E.ON is likely to build 7GW of new gas-fired electricity generation over the next eight years).
- It provides E.ON with a hedge and greater security for its acquisition of OGK-4 in Russia, which has 6.8GW of gas-fired power capacity (80% of the total) rising to 7.6GW by 2010.
- It provides vertical integration for E.ON's 24.5% interest in NordStream (formerly the North European Gas Pipeline), connecting Russia with Germany, where the first of two 27.5BCM parallel pipelines is scheduled to come on stream in 2010.

... as does Gazprom

For Gazprom, two major objectives would be achieved:

1. Access to storage

Gas suppliers need to have storage close to the markets they supply. The reasons for this are simple:

- Gas demand in Western Europe is higher in the winter than the summer. This is especially true in countries with a high retail heating segment.
- If demand is not flat throughout the year, it is more economically efficient to build storage close to the market to provide modulation of supply, rather than oversize the 3000km transit pipelines which run from Western Siberia to Europe.

- Typically, associated gas fields produce gas with a flatter profile than market demand – therefore gas storage is required to store gas between the summer and winter seasons rather than attempting to provide "swing" at the field.

Storage in Western Europe is strategically important for Gazprom as the company needs to ensure the availability of customer supplies given that:

- Gazprom lost over half of the available storage capacity from its transit network to western Europe when the Ukraine went independent.
- Gazprom's transit network is very extensive (over 80,000km of large diameter transit pipelines) but is ageing and could have reliability issues.
- Approximately 75% of Gazprom supplies to Western Europe pass through the Ukraine, with the remaining 25% passing through Belarus. As was shown in early 2006 and 2007, difficulties with transit through either of these countries can disrupt supplies to Western Europe.
- If Gazprom moves further downstream to directly supply customers, then it will need access to storage facilities – to date a lot of the storage has been provided by one of the downstream players in the chain rather than Gazprom.

E.ON is a major owner/operator of gas storage, with 5bcm in Germany. It is working on 0.2bcm in the UK (to open in 2009/10) and it owns around 6bcm through its holdings in the Baltic States (in which Gazprom itself also owns stakes), the Czech Republic, Slovakia and Hungary.

2. Access to downstream customers

The traditional model of Gazprom's supplies to Western Europe was to sell gas at the border to incumbent monopolists.

With the liberalisation of the European gas market and development of LNG technology, opportunities and threats have been created to this business model. New entrants have sought to compete through alternative sources of gas, for example LNG deliveries from Egypt. Incumbents have sought to diversify their sources of supply. And after coming under pressure from the European Commission, most suppliers will not sign any new long term contracts. Long-term contracts between Gazprom and its customers have traditionally underpinned the European business model, with existing contracts between various gas suppliers and Gazprom extended until the late 2030s.

With the advent of liberalisation, Gazprom is now able to compete directly with incumbents for access to end consumers, or take controlling interests in European gas market players. This gives the benefit of: (i) strengthening Gazprom's existing position by supplying controlled entities with Gazprom gas, rather than competitors' gas, (ii) access to information on downstream profitability, (iii) replacing the long-term contractual structure with a customer relationship structure, and (iv) economic rent – the wholesale market is not a liquid one, and in our view is unlikely to become one in Continental Europe in the medium term. Under these circumstances, vertical integration is valuable and enables the extraction of economic rent from the full value chain.

3. Integration into power production

We have seen Gazprom act at home to acquire stakes in Mosenergo, TGK-1 and the wholesale generators OGK-6 and OGK-2, as the restructuring of the Russian power sector progresses on schedule. Through these acquisitions, Gazprom locks in customers for its gas over the long term at a time when gas and power prices are in the early stages of liberalisation (the process should compete in 2011).

By taking stakes in E.ON's power generation facilities in Central and Western Europe, which are likely to consist mainly of CCGT units, Gazprom is increasing its level of integration as well as getting access to final users in the Western European markets to which it imports gas.

Conclusion: Yuzhno Russkoye is mutually beneficial for E.ON and Gazprom

As has been demonstrated, the Yuzhno-Russkoye/power plant-with-gas storage asset swap is highly beneficial to both E.ON and Gazprom, and we have increased our valuation of E.ON's gas business to reflect this. Given E.ON's stated optimism that the Yuzhno Russkoye deal will go through, we now believe it makes sense to include the deal in our valuation.

The knowledge that E.ON is to sharply raise output from an existing field, that it has access to a major pipeline transporting Russian gas to Europe, that it has a majority-owned downstream hedge for Russian gas production in the form of OGK-4, that it has cemented closer relations with Gazprom, and that it has contracts to import Gazprom's gas through the late 2030s, has a substantial strategic value.

Increase in our valuation of E.ON's gas business, still at discount to peers

As a result of E.ON's increased integration in gas, mainly through Yuzhno Russkoye but also through its investments in double storage capacity and potential to open at least 15BCM of LNG re-gasification capacity over the next seven years in Germany, Croatia, France, and Italy, we have raised our valuation of E.ON's gas activities to from €27bn to €32bn. This implies a prospective 2008 EV/EBITDA multiple of 7.9x, at a discount to its closest peers on an average 8.5x. We have also removed the 25% discount we previously applied to OGK-4, the Russian power generator acquired by E.ON in late-2007, because with Yuzhno Russkoye, E.ON now benefits from a vertical gas hedge (80% of OGK-4's capacity being gas-fired).

Swaps to be the order of the day: E.ON in a good position to create more value

Statkraft swap: boosted cost-efficiency potential, simplified structure, transaction multiples for Nordic Region

On a wider view, Yuzhno Russkoye follows a major swap between E.ON and Statkraft (Norway) that also provided a major boost to E.ON as it:

- Gives E.ON full control of E.ON Sverige, allowing greater group-wide economies of scale to be achieved, especially in trading.
- Demonstrates the multiples applicable to Nordic assets.
- Provides E.ON with a strong strategic partner in Statkraft, which is to take a 2% stake.
- Reduces E.ON's exposure to its home market.

Endesa: E.ON all the better for having failed

By the end of the first half 2008, E.ON will acquire €10-11bn of generation assets from Endesa and Enel in Spain (4.3GW), Italy (equity of 5GW), France (equity of 1.6GW), Poland and Turkey, in a transaction that is, to some extent, a swap, the swap being the withdrawal by E.ON from its bid for Endesa. It is worth stating that, had E.ON acquired Endesa, it would not have been in a financial position to: (i) make the recent acquisitions in upstream, renewables and Eastern Europe, or (ii) announce 13.5GW of new capacity over the coming years, short of carrying out a capital increase (in contrast to the €7bn of share buy-backs being carried out).

Note that we forecast a dip in the group EBIT margin in 2008 to 12.9x due to integration pressures but anticipate a rebound back to 13.3x as early as 2009.

No large acquisitions unless part of a swap or financed by a disposal

E.ON management has already stated that it will make no more significant outright acquisitions, unless either as part of a swap or funded by a disposal. We believe that, apart from its Spanish problems, E.ON management has shown itself adept at benefiting from the swapping of assets.

E.ON is ahead of the sector, whose common strategy (post-M&A) is to integrate

Now that large-scale M&A is behind us to a large extent, we expect swaps between the main utilities to accelerate as the latter pursue strategies of integration. The result of this is that, over time, the main utilities should start to resemble each other. But E.ON, with its true Pan-European presence (only one-third of generation capacity in Germany) and a healthy electricity-gas mix, has made the greatest gains in its pursuit of the ideal balance.

Sum-of-parts upgraded to €164

Below we summarise our new sum-of-parts valuation which has been raised from €150 to €164.

E.ON – *sum-of-the-parts: €164*

Utilities (€m)	Valuation methodology	€m	% of gross SOP	€/share
Electricity: nuclear generation	9898MW @ €1.15m EV/MW	11,382	9%	18.9
Electricity: thermal generation	35,956MW @ €0.88m EV/MW	30,673	25%	51.0
Electricity: hydro + wind generation	4,600MW @ €1.2m EV/MW	5,520	5%	9.2
Gas and oil production	5.5x 2008e EBITDA (€700m e) + equity interests	5.200	4%	8.6
OGK-4	Acquisition EV	4,100	3%	6.8
Airtricity North American assets	Acquisition price	991	1%	1.7
Total upstream		*57,866*	*47%*	*96.1*
Retail – gas, electricity	25.4m direct + 15m indirect power/gas accounts @ €280/acct	7,944	7%	13.2
Electricity high-voltage grid	18,820km high-voltage @ €109,000/km, 10% discount	2,185	2%	3.6
Electricity medium + low-voltage grid	385,000km @ €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	16,395	13%	27.2
Total distribution + supply		*41,779*	*34%*	*69.4*
Gazprom	6.4% stake = 82.9m direct + 49% of 69.4m – ADR price	15,491	13%	25.7
Other associates + financial LT investments	2006 annual report, pages 146-7	7,150	6%	11.9
Total other activities		*22,641*	*19%*	*37.6*
Total gross assets		**122,286**	**100%**	**203.1**
Group net cash/(debt)	End-2008e	(8,190)		-13.6
Nuclear + pension provisions	End 2008e	(14,350)		-23.8
Minorities, treasury stock, other	After Statkraft and Gazprom swaps	(1,355)		-2.7
Total sum-of-parts		**98,492**		**163.6**
Sum-of-the-parts per share (€)		**163.6**		

Source: SG Equity Research

Our forecasts are unchanged.

E.ON forecasts (IFRS)

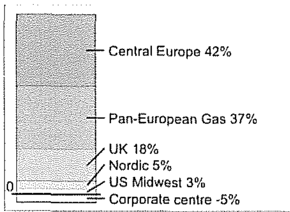
(€m)	2006	2007e	2008e	2009e	2010e	2011e
EBIT	8,356	9,194	10,500	11,322	12,283	13,218
Central Europe	4,235	4,830	5,048	5,425	5,778	6,111
Central Europe West Power	3,550	4,015	4,392	4,744	5,062	5,365
Central Europe West Gas	272	245	264	275	289	300
Central Europe East	269	310	334	349	371	388
Other/consolidation	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	1,751	1,891	1,976	2,115	2,263
Downstream	457	810	733	756	777	799
UK	1,239	1,097	1,198	1,269	1,327	1,387
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	8,981	9,499	10,262	11,216	12,244
Net reported	5,307	5,528	6,125	6,836	7,477	8,168
Net adjusted	4,682	5,278	5,875	6,586	7,227	7,918
Avg number of shares in EPS calculation (m)	659.1	652.0	632.7	618.0	618.0	618.0
EPS adjusted (€)	7.10	8.10	9.29	10.66	11.70	12.82

Source: SG Equity Research

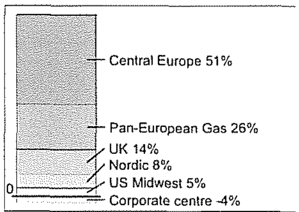
IMPORTANT DISCLOSURES

E.ON	*Societe Generale and affiliates beneficially own 1% or more of any class of common equity of E ON*
ENEL	*SG makes a market in Enel warrants*
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 acted as sole advisor to Gaz de France in the disposal of Cofathec ADF*
Gaz de France	*SG is advisor to Gaz de France in its merger project with Suez*
RWE	*Societe Generale and affiliates beneficially own 1% or more of any class of common equity of RWE.*

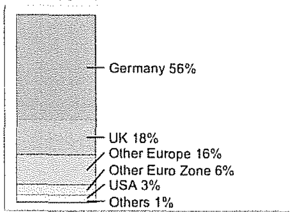
Sales/division 07e



EBIT/division 07e



Sales/region 07e



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 share buyback 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 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: $72.0	Target: $80.5		
(1 for 0.33 sh.)	06	07e	08e
P/E (x)	24.5	19.7	15.8
Yield (%)	1.9	2.6	3.4
P/CF (x)	10.0	8.6	8.4
€/$	1.26	1.37	1.49
Bloomberg	EONGY US		

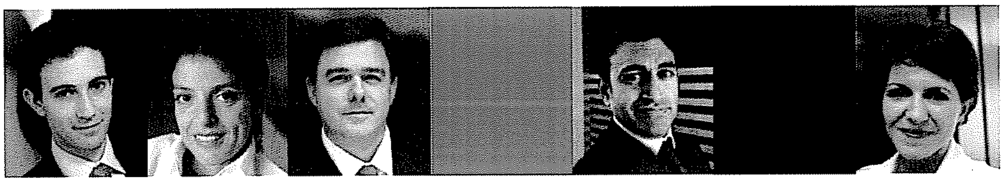
Electric Utilities (Germany)

E.ON

BUY — Price (14/01/08) **€145.0** — 12m target **€164.0**

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	659.1	652.0	632.7	618.0
Share price (average)	52.81	43.31	57.94	73.14	93.19	118.08	145.04	145.04
Average market cap. (SG adjusted) (1)	36,713	30,005	40,129	50,609	64,522	100,368	89,635	89,635
Restated net debt (-)/cash (+) (2)	-35,421	-32,192	-27,553	-19,379	-16,903	-25,040	-41,579	-42,565
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	125,408	131,213	132,200
P/E (x)	12.4	7.2	9.9	12.3	13.1	14.6	15.6	13.6
Price/cash flow (x)	6.2	nm	1.7	5.1	5.4	6.4	8.3	7.8
Price/free cash flow (x)	77.7	9.6	11.4	nm	3.3	21.2	35.4	34.7
Price/book value (x)	1.4	1.0	1.1	1.1	1.3	1.6	2.0	1.8
EV/revenues (x)	1.94	1.34	1.38	1.24	1.27	1.81	1.62	1.55
EV/EBITDA (x)	9.4	6.6	6.4	6.8	6.9	9.8	8.9	8.3
Dividend yield (%)	3.3	4.6	4.1	3.8	3.6	3.5	3.4	4.1
Per share data (€)								
SG EPS (adj.)	4.26	5.98	5.88	5.93	7.10	8.10	9.29	10.66
Cash flow	8.53	-1.27	34.38	14.32	17.38	18.59	17.38	18.59
Book value	37.07	45.51	51.00	67.50	70.30	72.22	72.45	80.86
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	13,310	15,267	16,383
EBITDA	7,680	9,458	10,520	10,257	11,789	12,770	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*	*9,194*	*10,500*	*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	-2,874	-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	5,528	6,125	6,836
SG adjusted net income	2,777	3,950	3,867	3,910	4,682	5,278	5,875	6,586
Cash flow statement (€m)								
EBITDA	7,680	9,458	10,520	10,257	11,789	12,770	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	-3,799	-4,875	-4,985
Cash flow from operating activities	3,690	5,633	6,059	-835	22,656	9,336	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	3,636	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	-1,573	-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	47,084	45,841	49,969
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	-8,190	-24,632	-25,520
Accounting ratios								
ROIC (%)	4.2	5.2	6.4	6.3	7.8	9.1	9.2	8.9
ROE (%)	7.8	14.3	13.8	18.9	11.7	11.8	13.2	14.3
Gross income/revenues (%)	25.2	21.1	23.2	19.6	18.4	19.3	18.8	19.3
EBITDA margin (%)	20.7	20.4	21.4	18.2	18.4	18.5	18.1	18.6
EBIT margin (%)	12.8	13.4	15.0	13.0	13.0	13.3	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	8.3	15.3	7.6
EBIT yoy growth (%)	28.1	31.6	18.2	-0.6	14.2	10.0	14.2	7.8
EPS (adj.) yoy growth (%)	8.9	40.5	-1.8	0.9	19.7	14.0	14.7	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	70.8	54.7	50.9
Net debt/equity (%)	43.5	32.0	14.5	nm	nm	16.5	51.8	49.3
FFO/net debt (%)	19.6	20.2	26.7	36.7	67.7	37.2	24.5	26.3
Dividend paid/FCF (%)	248.3	38.4	39.2	nm	25.3	60.8	101.1	119.5

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



E.ON AG

Unfinished symphony

Price Objective Change **BUY**

Equity | Germany | Electric Utilities
18 January 2008

Merrill Lynch

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First signs of delivery from new strategy

2008 could be a year E.ON delivers positive surprise on earnings and considers the sale of non-core assets. There is substantial scope to improve ROCE with the focus now back on integration and operational performance after chasing M&A the last few years. We also believe that the spotlight might turn to E.ON's underperforming financial assets which we value at c€30bn, and which includes the Gazprom stake. A release of some capital from this pool would be well received by the market we believe.

We have increased our power price assumptions, and as a result raised our PO to €165ps (from €150ps) and EPS forecasts. We also have moved our volatility risk rating from B (Medium Risk) to A (Low Risk).

Still upside on Raised PO

The shares have risen by over 40% since May 2007, yet over the period the 2009E PE multiple has only marginally expended (13.4x, 5 May). This is testimony to the earnings uplift both from power prices and higher expectations from the growth/financial strategy. Forecast 5-year EPS CAGR have doubled over the period. We remain attracted by the growth potential, the modest CO2 exposure and scope for portfolio rationalisation. The absolute upside has narrowed, though we still see c15% to our new PO of €165ps. We retain our Buy recommendation.

Estimates (Dec)

(EUR)	2005A	2006A	2007E	2008E	2009E
	IFRS	IFRS	IFRS	IFRS	IFRS
EPS (Reported)	11.24	7.67	7.71	8.70	10.44
EBITDA (Adjusted)	10,194	10,396	11,126	13,219	14,997
EPS (Adjusted)	5 52	6.66	7.71	9.02	10.4
EPS Change (YoY)	NA	20 5%	15.8%	17.0%	15.8%
Dividend / Share	2.75	3 35	4 24	4.78	5.74
ADR EPS (Adjusted - US$)	2 29	2.78	3.75	4.41	5.11
ADR Dividend / Share (US$)	1.14	1.40	2 06	2.34	2.81

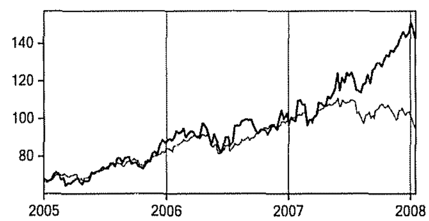
Valuation (Dec)

	2005A	2006A	2007E	2008E	2009E
P/E	26.3x	21 8x	18 8x	16.1x	13.9x
Dividend Yield	1.89%	2.31%	2.92%	3.29%	3.96%
EV / EBITDA*	10.5x	9.43x	8 70x	7.35x	6 47x
Free Cash Flow Yield*	2 72%	2.12%	-4 44%	-14.6%	0.25%
EV/EBITDA (Adjusted)	NA	NA	9.49x	9.22x	8 26x

* For full definitions of *iQmethod*SM measures, see page 11

Stock Data

Price (Common / ADR)	EUR145.22 / US$69.70
Price Objective	EUR150.00 to EUR165.00 / US$72.10 to US$82.80
Date Established	18-Jan-2008 / 18-Jan-2008
Investment Opinion	B-1-7 to A-1-7 / B-1-7 to A-1-7
Volatility Risk	LOW / LOW
52-Week Range	EUR94 40-EUR154.11
Market Value (mn)	EUR96,380
Shares Outstanding (mn)	663.7 / 1,993.0
Average Daily Volume	3,690,372
ML Symbol / Exchange	EONAF / GER
ML Symbol / Exchange	EON / OTU
Bloomberg / Reuters	EOA GR / EONG.DE
ROE (2007E)	10.1%
Net Dbt to Eqty (Dec-2006A)	0 5%
Est. 5-Yr EPS / DPS Gwth	15.6% / 14.2%
Free Float	91.1%



– E ON – DJ EURO STOXX 50 P INDEX

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Refer to important disclosures on page 12 to 14. Analyst Certification on page 10. Price Objective Basis/Risk on page 10.

iQprofile[SM] E.ON AG

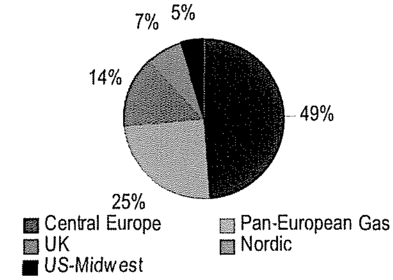
Key Income Statement Data (Dec)	2005A	2006A	2007E	2008E	2009E
(EUR Millions)	IFRS	IFRS	IFRS	IFRS	IFRS
Sales	56,141	67,759	68,229	74,133	80,652
EBITDA Adjusted	10,194	11,353	12,309	14,581	16,564
Depreciation & Amortization	(2,901)	(3,203)	(3,136)	(3,701)	(4,092)
EBIT Adjusted	7,293	8,150	9,173	10,881	12,472
Net Interest & Other Income	(1,027)	(1,081)	(1,436)	(2,069)	(2,556)
Tax Expense / Benefit	(2,261)	323	(2,166)	(2,491)	(2,578)
Net Income (Adjusted)	3,640	4,386	4,973	5,696	6,607
Average Fully Diluted Shares Outstanding	659	659	645	632	633
Key Cash Flow Statement Data					
Net Income (Reported)	7,407	5,057	4,973	5,496	6,607
Depreciation & Amortization	2,901	3,203	3,136	3,701	4,092
Change in Working Capital	(532)	(1,568)	(141)	(744)	(665)
Deferred Taxation Charge	0	0	0	0	0
Other Adjustments, Net	(3,232)	502	(416)	709	575
Cash Flow from Operations	6,544	7,194	7,552	9,162	10,608
Capital Expenditure	(3,941)	(5,161)	(11,718)	(22,511)	(10,380)
(Acquisition) / Disposal of Investments	(985)	(1,078)	(1,443)	(1,241)	(1,041)
Other Cash Inflow / (Outflow)	5,368	1,738	1,443	1,241	1,041
Cash Flow from Investing	442	(4,501)	(11,718)	(22,511)	(10,380)
Share Issue / (Repurchase)	(26.0)	1.00	(3,500)	(1,730)	0
Cost of Dividends Paid	(1,788)	(4,856)	(2,486)	(3,053)	(3,363)
Cash Flow from Financing	(6,458)	(5,849)	(5,986)	(4,553)	(3,363)
Non Cash Changes to Debt	(295)	(38.0)	0	0	0
Change in Net Debt	(5,434)	2,096	10,152	17,902	3,135
Net Debt	(1,917)	268	9,982	27,671	30,806
Key Balance Sheet Data					
Property, Plant & Equipment	45,448	46,461	57,340	73,750	80,038
Goodwill	15,363	15,124	14,541	14,316	14,316
Other Intangibles	NA	NA	NA	NA	NA
Other Non-Current Assets	21,505	23,215	24,658	25,898	26,939
Trade Receivables	8,269	9,756	9,824	10,561	11,269
Cash & Equivalents	16,279	13,131	13,131	13,131	13,131
Other Current Assets	19,698	19,545	18,873	19,256	19,684
Total Assets	126,562	127,232	138,365	156,912	165,377
Long-Term Debt	14,362	13,399	23,113	40,802	43,937
Other Non-Current Liabilities	43,930	41,857	40,228	40,113	39,956
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	19,052	19,214	19,168	19,510	19,936
Total Liabilities	77,344	74,470	82,510	100,425	103,830
Total Equity	49,218	52,762	55,856	56,487	61,547
Total Equity & Liabilities	126,562	127,232	138,365	156,912	165,377
Key Metrics					
iQmethod*[SM] - Bus Performance					
Return On Capital Employed	4.48%	6.81%	5.80%	6.05%	6.49%
Return On Equity	9.33%	9.50%	10.1%	10.8%	11.5%
Operating Margin	13.0%	12.0%	13.4%	14.7%	15.5%
Free Cash Flow (MM)	2,603	2,033	(4,166)	(13,349)	228
iQmethod*[SM] - Quality of Earnings					
Cash Realization Ratio	1.80x	1.64x	1.52x	1.61x	1.61x
Asset Replacement Ratio	1.36x	1.61x	3.74x	6.08x	2.54x
Tax Rate	36.1%	NM	28.0%	28.3%	26.0%
Net Debt/Equity	-3.89%	0.51%	17.9%	49.0%	50.1%
Interest Cover	7.05x	7.36x	6.28x	5.19x	4.83x

* For full definitions of *iQmethod*[SM] measures, see page 11

Company Description

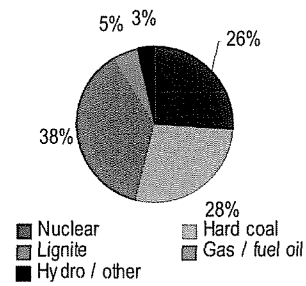
E.ON has transformed itself from domestic conglomerate to one of Europe's biggest energy utilities, with a portfolio of mainly vertically integrated assets across Germany, Central Europe, the Nordic Region, UK and US. The acquisition of assets in Spain, Italy and France are due to be completed in 2008. Active in both electricity and gas, it is well positioned to grow from this platform as power/gas convergence gathers pace over the next decade.

Chart 1: 2006A EBIT



Source: Company Data

Chart 2: Generation Output Germany

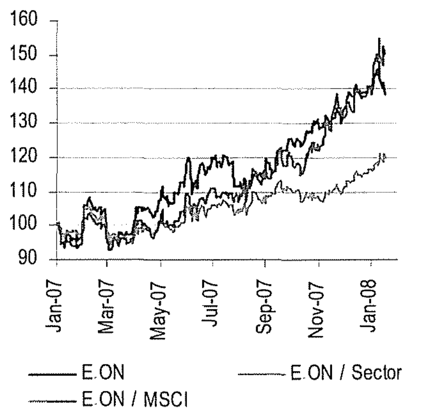


Source: Company data

Stock Data

Shares / ADR	0.33
Price to Book Value	1.8x

Chart 3: E.ON Share Price Performance since January 2007



Source: Datastream

Unfinished Symphony

E.ON's strategy shift in 2007 has been ecstatically received by the stock market. The change in direction essentially marked an end of the transforming M&A pursued over the last few years, and the start of a new focus on long term organic growth, as well as operating and capital efficiency. The market lapped it up, with the shares outperforming by 35% in the eight months since the strategy meeting in May 2007.

After this major re-rating, *can investors expect more in 2008E?* Certainly E.ON's strategy is not just 'unfinished', but is at only the very early stages of delivery. For example E.ON's EBIT target was set for 2010E; whilst a significant proportion of the €42bn of growth investment planned for 2007-10E will not generate 'plateau' returns until 2011E or 2012E. It may be four or five years before the symphony enters the final climactic movement of earnings and cash flow delivery.

Despite this longer term perspective we think there are potential milestones on E.ON's strategic roadmap which could emerge during 2008E.

- **E.ON Spain/Italy:** The c€10bn acquisition should complete during 1H, once a valuation is agreed. These markets, and Italy in particular, likely will be key building blocks for E.ON.
- **Integration returns:** E.ON's portfolio is largely built out of a series of acquisitions in and outside of Germany. It has never really been run as an integrated business in our view. We think there could be substantial upside surprise from cost cutting, streamlined investment planning, procurement and Trading. The first fruits from these efforts could show through in 2008E.
- **Sale of non-core assets:** We identified €30bn of low returning assets in our note *E.ON - Catalysts for Change*, 30 April 2007. Chief among these is Gazprom (c€11bn, on which E.ON receives a dividend yield of just 0.8%) plus transmission and distribution assets.

Time to sell Gazprom?

E.ON's investment in Russia is about to enter a new phase with the 2007 acquisition of OGK-4 and the expected 25% equity in the gas field development of Yushno Russkoje. We estimate that E.ON could have €20-25bn invested in Russia wthin 3-5 years – 25% of total Capital Employed of c€100bn by the turn of the decade.

We think this is too much, and it would make sense for E.ON to look to sell down the Gazprom stake, which is held in two parts, 3.5% directly, the remainder in a JV vehicle. The opportunity politically to sell down the direct stake, worth €6bn, could emerge after the Presidential elections in March 2008.

The stock market would receive such a move very positively in our view. The sale of Gazprom would partially derisk the portfolio and realize a substantial book given the in price of near €1bn (MLe). Given the current low returns from Gazprom, we think investors might be ambivalent as to whether the capital were re-allocated into new, WACC-plus growth investments or to be returned to shareholders.

Challenges for 2008E

- **Regulation:** The regulator increased tariff cuts for 2008 to high single digit from the expected low single digit. The response is likely to be further cost-cuts. Incentive regulation is on schedule to begin 1 January 2009E.

- **Power prices/Cartel Office:** The upward trajectory of base load prices in Germany promise a surge in profitability for E.ON Central Europe and Nordic through the next few years. In Germany, amendments to the Cartel Law provide the FCO with greater powers to scrutinise price movements. Our own view is that this is akin to the 'video referee' in football – so long the players do not stray 'offside' ie prices are set in the free market on the EEX, and German prices are not materially adrift of those in adjacent markets, the industry has little to fear in practice.

- **Carbon NAP 3:** The EU is due to deliver its first salvo on NAP 3 for the ETS on 23 January. E.ON faces additional CO2 costs in Germany of c€0.4-0.5bn in Phase 3 assuming 100% auctioning – just 3% of EBIT. NAP 3 therefore represents much less of a threat than for RWE.

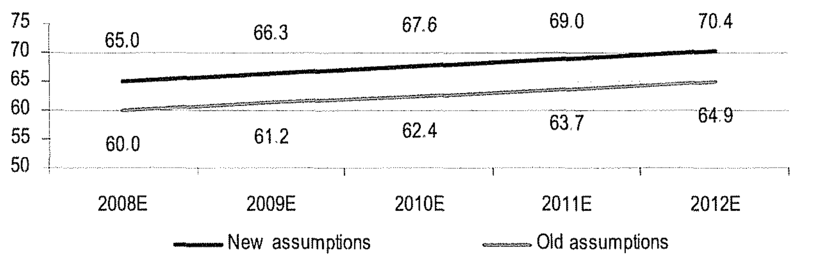
- **Unbundling:** E.ON, like RWE is, in public, opposed to EU plans to separating Transmission assets from generation and supply. There may be two choices – either independent ownership (demerger) or ownership with control ceded to an ISO. We believe that if the latter is the compromise option, E.ON (and others) may as well exit. We estimate E.ON's Transmission assets (including gas) as worth c€10-12bn (EV).

- **UK windfall tax:** the UK Government is understood to have been presented with proposals by OfGem to claw back free allocations for Phase 2. We think this is unlikely to be followed through – it would send a very negative message on the UK's hitherto top flight reputation for free markets in energy, and disincentivise the builders of the much needed next wave of UK power plants. If it happened, E.ON could face a bill of c£1bn, or €2ps.

Power Prices

We have increased our base case power price assumptions for Germany from €60/MWh to €65/MWh (maintained in real terms). The increase reflects a view that input prices will stay higher for longer, and incorporate ML's recent increase long term oil price (from $60/bbl to $70/bbl). Our €65/MWh assumption is at the low end of the €60-80/MWh range we estimate the industry needs to justify building new fossil fuel plant (see *Year Ahead 2008*, published 18 January).

Chart 4: EEX Baseload - ML assumptions (€/MWh)



Source: Merrill Lynch estimates

Earnings Forecasts

We have increased our forecasts for Operating Income by around 2-7% for 2008E to 2010E, the bigger increases back end loaded to reflect the lagged effect of wholesale power contracting. The EPS increases are higher (5% to 19%), because of the accretive acquisition of Sverige minorities and we are using a lower tax rate than previously.

We have raised our EPS forecasts for 2007E by 7%. The increase reflects primarily lower taxes as E.ON adjusts to the lower corporate rate in Germany which comes into force in 2008E.

By and large these changes feed through to our DPS forecasts. Specifically we have increased our 2007E DPS by 7% to €4.24ps (55% payout), and a 27% rise on 2006A.

Table 1: Change in ML estimates

	2007E	2008E	2009E	2010E	2011E
Realised price (€/MWh)					
New estimates	45.4	55.5	60.6	66.4	69.0
Old estimates	45.4	54.9	57.8	61.7	63.7
% change	0%	1%	5%	8%	8%
EBITDA (€m)					
New estimates	12,309	14,581	16,564	18,778	20,114
Old estimates	11,931	14,326	16,133	17,959	19,406
% change	3%	2%	3%	5%	4%
Operating income (€m)					
New estimates	9,173	10,881	12,472	14,250	15,317
Old estimates	8,677	10,620	11,991	13,337	14,447
% change	6%	2%	4%	7%	6%
Recurrent EPS (€ps)					
New estimates	7.71	9.02	10.44	12.40	13.74
Old estimates	7.20	8.60	9.37	10.40	11.36
% change	7%	5%	11%	19%	21%
DPS (€ps)					
New estimates	4.24	4.78	5.74	5.99	6.51
Old estimates	3.96	4.73	5.15	5.71	6.25
% change	7%	1%	12%	5%	4%

Source: Merrill Lynch estimates

Valuation

We have increased our valuation to €165ps from €150ps. The main changes are higher power price assumptions and rolling forward the discount date to end 2008E.

Table 2: Sum of the Parts Valuation

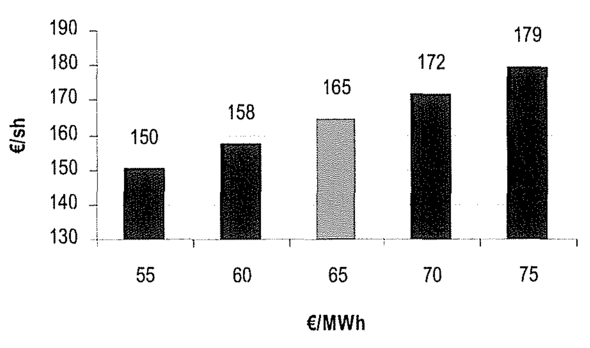
Division	€m	€ p.s.	% EV	Method	Implied multiple
Central Europe	65,813	101	*42%*	DCF, 7.5-8% WACC	9.3x 08E EBITDA
Pan-European Gas (ex Gazprom)	24,318	37	*16%*	DCF, 7.5% WACC	8.9x 08E EBITDA
United Kingdom	14,149	22	*9%*	Multiples per kW, Premium to RAV	*8.8x 08E EBITDA*
Nordic	14,517	22	*9%*	DCF, 7.5% WACC	10.2x 08E EBITDA
US	4,633	7	*3%*	DCF, 6% WACC	8.0x 08E EBITDA
Integration benefits	3,694	6	*2%*	DCF, 9% WACC	
Gazprom	10,843	17	*7%*	PE, Market Value post tax	
Corporate Center	-3,536	-5	*-2%*		10.0x 08E EBITDA
EV	**152,313**	**234**	***98%***		10.2x 08E EBITDA
Treasury Shares	2,788	**4**	***2%***	Market value	
Total EV	***155,102***	***238***	***100%***		***10.2x*** *08E EBITDA*
(Net Fin Debt) / Cash	-27,671	-42		Dec 08E	
Provisions	-18,704	-29			
Nuclear	-14,418	-22		Dec 08E	
Pension	-1,984	-3		Dec 08E	
Mining / Environ.	-2,302	-4		Dec 08E	
Minority Interests	-1,285	-2		Dec 08E	
Equity Value	**107,442**	**165**			

Source: Merrill Lynch estimates

Valuation Sensitivity

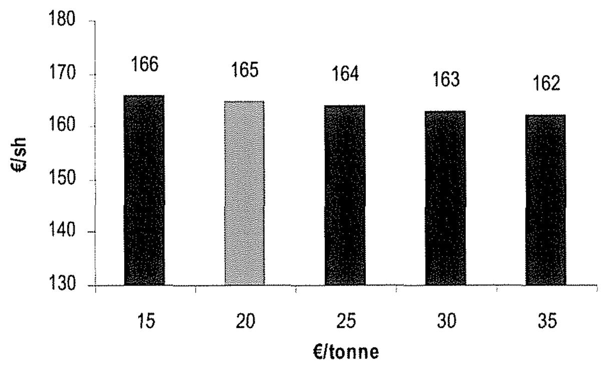
We have run sensitivity analyses for power prices and carbon costs, shown in Chart 5 and Chart 6. These show a) E.ON's sensitivity to power prices, assuming flat carbon costs (ML's base case of €20/t) and b) the comparatively modest sensitivity to carbon costs (using ML's base case power price of €65/MWh).

Chart 5: Sensitivity to Power Price



Source: Merrill Lynch estimates

Chart 6: Sensitivity to CO_2 Price



Source: Merrill Lynch estimates

Valuation Multiples

Table 3 below shows valuation multiples for E.ON and its peers.

Table 3: Valuation Multiples

Company	Price (local)	Mkt Cap (€m)	EV (€m)	PE Multiple 08E	PE Multiple 09E	PE Multiple 10E	EPS 4Yr CAGR	Gross Yield 08E	DPS 4Yr CAGR	EV/EBITDA 08E	EV/EBITDA 09E	EV/EBITDA 10E	EBITDA 4Yr CAGR
E.ON	142.9	94,840	105,573	15.8x	13.7x	11.5x	16.8%	3.3%	19.4%	9.2x	8.3x	7.4x	12.8%
E.ON at Price Objective	165.0	109,507	137,314	18.3x	15.8x	13.3x	16.8%	2.9%	19.4%	10.3x	9.2x	8.2x	12.8%
Competitive Energy													
RWE	94.0	52,883	74,120	12.9x	11.4x	9.9x	21.3%	5.8%	12.9%	7.6x	6.8x	6.3x	10.3%
Fortum	27.9	24,599	28,801	16.7x	13.9x	12.2x	18.5%	3.6%	2.2%	11.7x	10.0x	8.8x	14.1%
Verbund	44.2	13,652	15,572	16.5x	14.8x	13.4x	19.0%	2.8%	19.3%	10.6x	9.6x	8.6x	14.3%
CEZ AS	1202.0	25,034	784,424	14.3x	12.6x	11.2x	23.0%	4.2%	34.0%	8.7x	7.9x	7.2x	12.5%
EDF	77.4	141,037	187,001	27.1x	23.3x	19.2x	24.9%	1.8%	14.8%	10.5x	9.6x	8.5x	8.4%
Average													
Competitive Energy Avg				20.2x	17.0x	14.5x	20.5%	3.2%	15.9%	9.6x	8.7x	7.8x	10.2%
Pan Euro Sector Avg				19.7x	16.6x	14.6x	17.9%	3.4%	15.4%	9.6x	8.7x	8.1x	9.3%

Source: Merrill Lynch estimates

Financials

Table 4: Profit and Loss Account (€m)

	2005A	2006A	2007E	2008E	2009E	2010E	2011E	06A -11E CAGR
Total Sales	**56,141**	**67,759**	**68,229**	**74,133**	**80,652**	**83,908**	**86,096**	
Adjusted EBITDA	**10,194**	**11,353**	**12,309**	**14,581**	**16,564**	**18,778**	**20,114**	*12.1%*
Central Europe / Russia	*5,284*	*5,484*	*6,479*	*7,108*	*7,717*	*8,930*	*9,579*	
Pan-European Gas	*1,939*	*2,839*	*2,938*	*3,134*	*3,210*	*3,554*	*3,924*	
Southern Europe / France				*927*	*1,760*	*1,922*	*1,978*	
UK	*1,550*	*1,790*	*1,600*	*1,606*	*1,661*	*1,725*	*1,783*	
Nordic	*1,115*	*992*	*1,081*	*1,428*	*1,661*	*1,830*	*1,940*	
US-Midwest	*560*	*590*	*555*	*582*	*618*	*685*	*782*	
Integration benefits				*150*	*300*	*500*	*500*	
Corporate Center/Consolidation	*-386*	*-342*	*-345*	*-354*	*-363*	*-369*	*-374*	
Adjusted EBIT	**7,293**	**8,150**	**9,173**	**10,881**	**12,472**	**14,250**	**15,317**	*13.4%*
Central Europe / Russia	*3,930*	*4,168*	*5,109*	*5,609*	*6,219*	*7,205*	*7,785*	
Pan-Euro Gas	*1,536*	*2,106*	*2,305*	*2,373*	*2,401*	*2,649*	*2,919*	
Southern Europe / France				*619*	*1,151*	*1,265*	*1,310*	
UK	*963*	*1,229*	*1,058*	*1,079*	*1,108*	*1,147*	*1,189*	
Nordic	*766*	*619*	*703*	*1,045*	*1,265*	*1,426*	*1,528*	
US-Midwest	*365*	*391*	*364*	*380*	*413*	*448*	*482*	
Integration benefits				*150*	*300*	*500*	*500*	
Corporate Center/Consolidation	*-399*	*-363*	*-366*	*-375*	*-385*	*-391*	*-396*	
Financial expenses	-1,027	-1,081	-1,436	-2,069	-2,556	-2,649	-2,564	
PBET	**6,266**	**7,069**	**7,737**	**8,811**	**9,917**	**11,601**	**12,753**	
Extraordinary items and non operating income	886	-1,936	0	0	0	0	0	
PBT	**7,152**	**5,133**	**7,737**	**8,811**	**9,917**	**11,601**	**12,753**	
Income tax	-2,261	323	-2,166	-2,491	-2,578	-3,016	-3,316	
Minority interests	-536	-526	-598	-824	-731	-740	-746	
Net income, continuing	**4,355**	**4,930**	**4,973**	**5,496**	**6,607**	**7,845**	**8,691**	
Income from disct / Other	3,052	127	0	0	0	0	0	
Group Net Income	**7,407**	**5,057**	**4,973**	**5,496**	**6,607**	**7,845**	**8,691**	***11.4%***
Recurrent Group Net Income	**3,640**	**4,386**	**4,973**	**5,696**	**6,607**	**7,845**	**8,691**	***14.7%***
Growth	*6%*	*20%*	*13%*	*15%*	*16%*	*19%*	*11%*	
Reported EPS (EUR p.s.)	*11.24*	*7.67*	*7.71*	*8.70*	*10.44*	*12.40*	*13.74*	***12.4%***
Recurrent EPS (EUR p.s.)	*5.52*	*6.66*	*7.71*	*9.02*	*10.44*	*12.40*	*13.74*	***15.6%***
DPS (EUR p.s.)	*2.75*	*3.35*	*4.24*	*4.78*	*5.74*	*5.99*	*6.51*	***14.2%***
Of which exceptional	*4.25*							
Payout ratio (on recurrent earnings)	*50%*	*50%*	*55%*	*53%*	*55%*	*48%*	*47%*	

Source: Merrill Lynch estimates

Table 5: Cash Flow Statement (€m)

	2005A	2006A	2007E	2008E	2009E	2010E	2011E	06A -11E CAGR
Net income	7,407	5,057	4,973	5,496	6,607	7,845	8,691	
Minority Interests	536	526	598	824	731	740	746	
Income from discontinued operations	-3,059	-127	0	0	0	0	0	
Depreciation, Amortisation, Impairments	3,030	3,751	3,136	3,701	4,092	4,528	4,797	
Gains / Losses on Disposals	-478	-1,322	0	0	0	0	0	
Change in provisions	-380	-1,769	-1,014	-116	-157	-204	-259	
Change in deferred taxes	0	0	0	0	0	0	0	
Change in working capital	-532	-1,568	-141	-744	-665	-549	-354	
Other non-cash items	20	2,646	0	0	0	0	0	
Cash Flow from Operations	**6,544**	**7,194**	**7,552**	**9,162**	**10,608**	**12,360**	**13,620**	*13.6%*
Disposals	6,294	3,954	0	0	0	0	0	
Investments	-3,941	-5,161	-11,718	-22,511	-10,380	-8,545	-4,173	
Change in securities > 3 months and other liquid funds	-1,911	-3,294	0	0	0	0	0	
Cash Flow from Investments	**442**	**-4,501**	**-11,718**	**-22,511**	**-10,380**	**-8,545**	**-4,173**	
Free cash flow	**3,588**	**3,111**	**-4,166**	**-13,349**	**228**	**3,815**	**9,447**	*24.9%*
Change in equity	0	0	-3,500	-1,730	0	0	0	
Net change in treasury stock	-33	28	0	230	0	0	0	
Payment of cash dividends	-1,788	-4,856	-2,486	-3,053	-3,363	-3,974	-4,658	
Net proceeds from financial liabilities	-4,611	-1,022	0	0	0	0	0	
Cash flow from Financing	**-6,458**	**-5,849**	**-5,986**	**-4,553**	**-3,363**	**-3,974**	**-4,658**	
Net cash income / outgoings	528	-3,156	-10,152	-17,902	-3,135	-160	4,790	
Forex impact on net cash	77	0	0	0	0	0	0	
Cash from discontinued operations	-372	-38	0	0	0	0	0	
Change net cash & equivalents	**233**	**-3,194**	**-10,152**	**-17,902**	**-3,135**	**-160**	**4,790**	

Source: Merrill Lynch estimates

Table 6: Balance Sheet (€m)

	2005A	2006A	2007E	2008E	2009E	2010E	2011E
Net Goodwill	15,363	15,124	14,541	14,316	14,316	14,316	14,316
PPE & Intangibles	45,448	46,461	57,340	73,750	80,038	84,055	83,432
Financial Assets	25,808	28,302	29,745	30,985	32,026	32,026	32,026
Fixed Assets	**86,619**	**89,887**	**101,625**	**119,050**	**126,379**	**130,397**	**129,773**
Inventories	2,457	3,990	4,018	4,365	4,749	4,941	5,070
Receivables	24,473	24,062	24,130	24,867	25,575	26,030	26,336
Liquid Funds, Non-Cash	5,551	5,035	5,035	5,035	5,035	5,035	5,035
Cash & Cash Equivalents	4,346	1,152	1,152	1,152	1,152	992	5,782
Non-Fixed Assets	**37,508**	**34,849**	**34,334**	**35,420**	**36,511**	**36,998**	**42,223**
Other	2,435	2,496	2,406	2,442	2,486	2,496	2,505
TOTAL ASSETS	**126,562**	**127,232**	**138,365**	**156,912**	**165,377**	**169,891**	**174,500**
Shareholders' Equity	**44,484**	**47,845**	**50,616**	**55,202**	**59,867**	**64,088**	**68,474**
Minority Interests	4,734	4,917	5,240	1,285	1,680	2,079	2,482
Provisions	33,862	32,093	31,079	30,964	30,807	30,603	30,344
Financial Liabilities	14,362	13,399	23,113	40,802	43,937	43,937	43,937
Operating Liabilities	19,052	19,214	19,168	19,510	19,936	20,035	20,115
Other	9,237	9,149	9,149	9,149	9,149	9,149	9,149
TOTAL EQUITY & LIABILITIES	**126,562**	**127,232**	**138,365**	**156,912**	**165,377**	**169,891**	**174,500**

Source: Merrill Lynch estimates

Price objective basis & risk

E.ON (EONAF) €165

Our Sum of the Parts valuation and Price Objective are €165ps. The long term nature of E.ON's assets lends itself to DCF. We use discount rates between 7.25% and 8.0% for the Central Europe, Pan European Gas and Nordic divisions, and multiples per installed capacity, customers and of RAB for the UK, in line with the industry average, market value for Gazprom. This valuation implies an 08E EV/EBITDA of 10.2x, in line with the sector.

The risks to our valuation and price objective are lower wholesale electricity, gas and oil prices. E.ON is also exposed to regulatory risk through its transmission and distribution businesses. The discount rate used in our DCF calculation is based on the prevailing cost of debt and equity, which may change with market conditions.

Gazprom (RGZPF)

Our price objective of $18.75/share ($75/ADR) is based on target P/E multiple of 11x 2008E Earnings, in line with its historical average forward earnings multiple and its international peers.

The risks to our price objective are oil prices, failure to contain costs, lower domestic gas price increases, adverse tax changes, value destruction from diversification into non-core businesses and failure to execute huge investment projects on-time and within budget. Gazprom's increased size has raised expectations for corporate disclosure, which the company may not be able to match.

ML is providing general financial advisory services to Gazprom OAO

Analyst Certification

We, Simon Flowers and Hootan Yazhari, CFA, hereby certify that the views each of us has expressed in this research report accurately reflect each of our respective personal views about the subject securities and issuers. We also certify that no part of our respective compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

iQmethod SM Measures Definitions

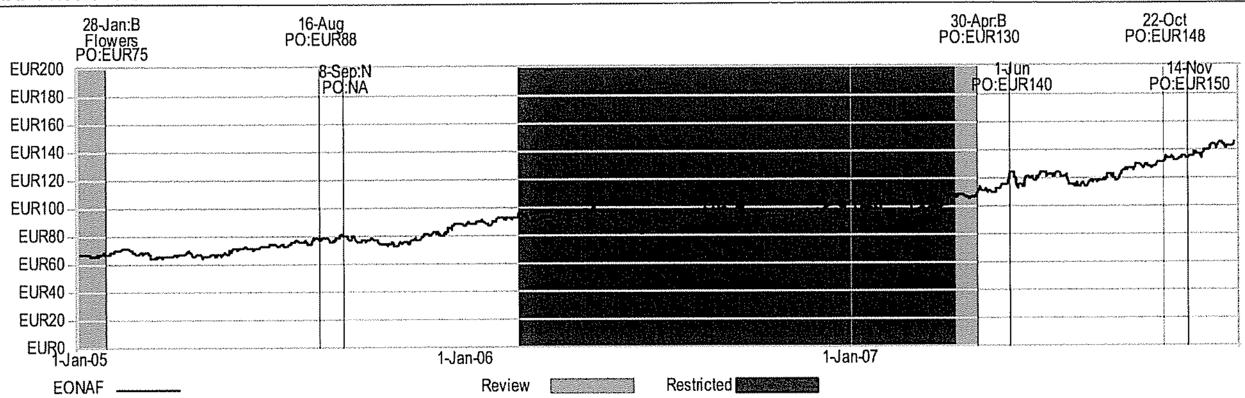
Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

iQmethod SM is the set of Merrill Lynch standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations The key features of iQmethod are: A consistently structured, detailed, and transparent methodology Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls

iQdatabase SM is our real-time global research database that is sourced directly from our equity analysts' earnings models and includes forecasted as well as historical data for income statements, balance sheets, and cash flow statements for companies covered by Merrill Lynch

Important Disclosures

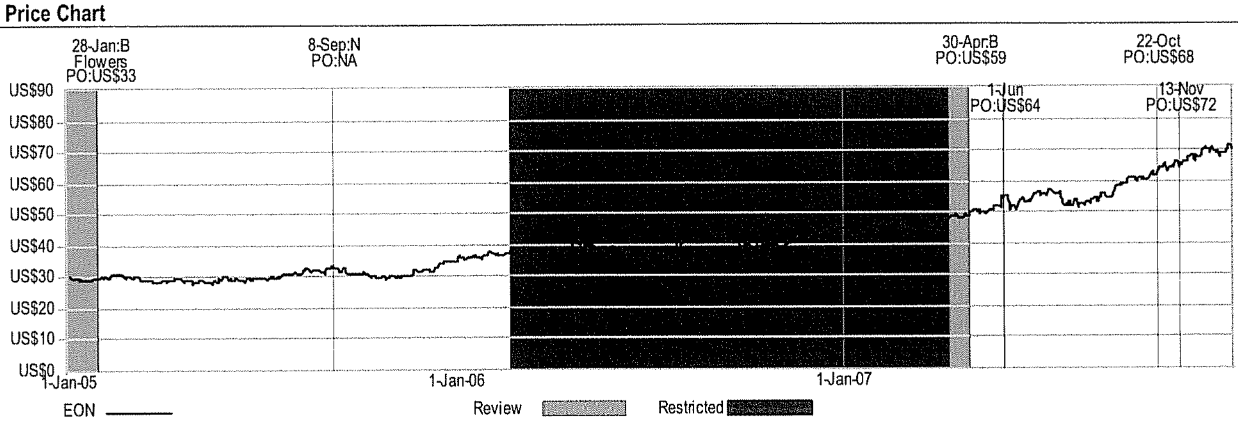
EONAF Price Chart



B : Buy, N : Neutral, S : Sell, PO : Price objective, NA : No longer valid

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key" Dark Grey shading indicates the security is restricted with the opinion suspended Light Grey shading indicates the security is under review with the opinion withdrawn Chart current as of December 31, 2007 or such later date as indicated

EON Price Chart



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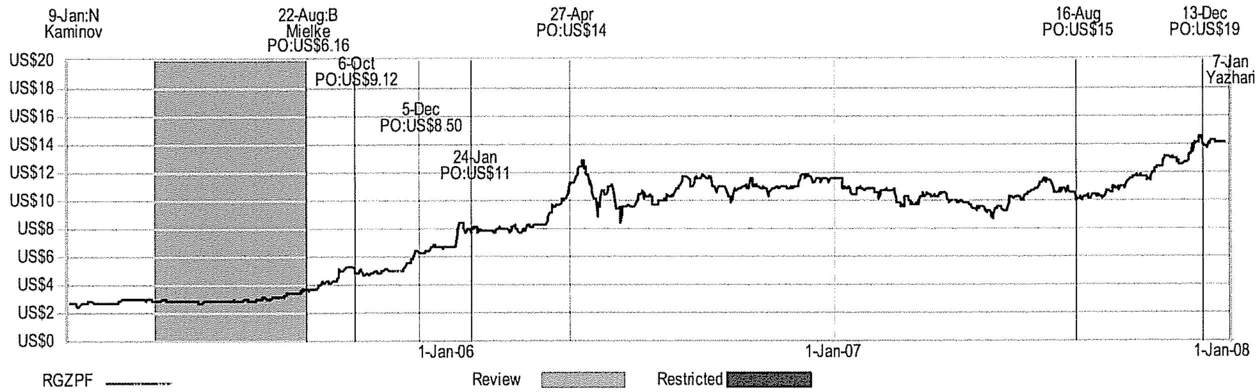
RGZPF Price Chart



B : Buy, N : Neutral, S : Sell, PO : Price objective, NA : No longer valid

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key" Dark Grey shading indicates the security is restricted with the opinion suspended Light Grey shading indicates the security is under review with the opinion withdrawn Chart current as of December 31, 2007 or such later date as indicated.

Investment Rating Distribution: Energy Group (as of 01 Jan 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	127	48.11%	Buy	44	40.00%
Neutral	117	44.32%	Neutral	31	31.00%
Sell	20	7.58%	Sell	4	21.05%

Investment Rating Distribution: Utilities Group (as of 01 Jan 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	67	40.12%	Buy	21	36.21%
Neutral	80	47.90%	Neutral	31	44.93%
Sell	20	11.98%	Sell	3	15.79%

Investment Rating Distribution: Global Group (as of 01 Jan 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1714	46.25%	Buy	445	29.10%
Neutral	1653	44.60%	Neutral	454	30.55%
Sell	339	9.15%	Sell	67	21.82%

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Germany

NEWS

UTILITIES

E.ON

Lowered TP due to tighter CO_2 allocation

- *TP lowered to EUR140 (EUR146)*
- *3/UP maintained due to risk from CO_2 costs and Cartel Office*
- *Safe haven argument has not worked out so far*

TP lowered to EUR140 (EUR146)

Following official statements from the EU Commission that utilities will not receive any CO_2 certificates for free from 2013 (see also our What's News from 9 January 2008), we have lowered our price target for E.ON from EUR146 to EUR140.

3/Underperform maintained

Although the stock now offers some 18% upside after the sudden share price drop and we might see a technical rebound, we stick to our 3/Underperform rating for the following reasons.

Risk from rising CO_2 prices

First of all, we have assumed a CO_2 price from 2013 of EUR23 per tonne. Given that allocations will be tighter than they are currently, there is a risk of rising CO_2 prices to trigger a fuel switch. Assuming a CO_2 price of EUR40 per tonne instead of EUR23, and also assuming no compensation through higher electricity prices, our price target would drop to EUR126, though this is a fairly pessimistic scenario.

Negative news flow ahead

Furthermore, during our German Corporate Conference, which E.ON attended, we had the impression that investors were in no way concerned about the Federal Cartel Office's ability to reverse recent electricity price increases with immediate effect. Hence, we see a likelihood of unexpected negative news flow in the weeks and months ahead.

Questionable safe haven argument

Although utilities should serve as a safe haven these days, between Monday and Wednesday this week E.ON shares lost 19% while the DAX declined by 'only' 12%. We think this is related to recession fears, which are likely to lead to a drop in oil and electricity prices.

Sebastian Kauffmann
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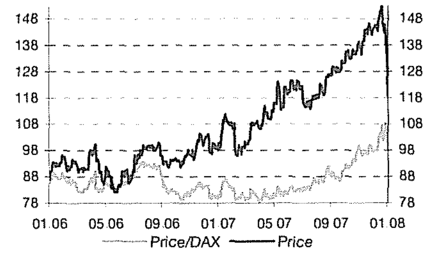
Rating	**3/Underperform**
Target price (6 months)	**+18% EUR140.00**
Price (23/01/08)	**EUR118.79**
Market capitalisation	EUR71.951bn

Reuters: **EONG.DE** Bloomberg: **EOA GR**



To 31/12 (EUR)	2007E	2008E	2009E
Sales (m)	69079	80450	86553
NAP, rest. (m)	6310	5648	6035
Clean EPS	9.67	9.13	9.96
P/E bef. GW (x)	15.1	13.0	11.9
EV/EBITDA (x)	9.0	7.3	6.9
EV/EBITA (x)	12.2	9.7	9.2
FCF yield (%)	2.7	-9.2	-0.4
ROE (%)	13.9	12.0	12.0
Net yield (%)	2.7	3.8	4.2

Sector focus

Sector Top Picks	Enagas, Suez
Least favoured	Gas Natural, Theolia

BEST REGARDS,
CHEUVREUX

January 24, 2008

ACTION

Buy

E.ON (EONG.DE)

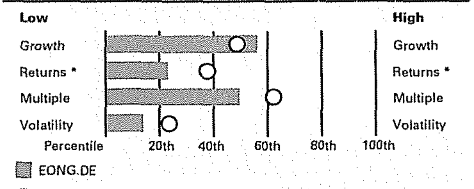
Return Potential: 28%

Upgrading to Buy from Neutral

Source of opportunity

We upgrade E.ON to Buy from Neutral as the stock now offers attractive absolute and sector-relative valuation upside. We see 28% upside to our 12-month price target of €152 and 15%-16% upside to average sector 2008E EV/EBITDA and P/E multiples. 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 programme through acquisitions and organic capex. We expect E.ON to deliver good earnings growth for 2008 and reach its 3x economic net debt/EBITDA target debt factor by the year-end.

Investment Profile: E.ON



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

Catalyst

At its 2007 results on March 6, we expect E.ON to provide further visibility on the pace of the capex programme and the future earnings growth. In 2008, we forecast EBITDA growth of 21% and clean EPS growth of 27%, driven by higher achieved power prices and the impact of first-time consolidation of acquisitions made in 2007 and the Spanish and Italian asset deal currently pending. We also expect the shares to be supported by the ongoing €7 bn share buyback programme, of which €3.5 bn in 2008. E.ON plays to the theme of low carbon generators and we believe it has opportunities to create value through investments in new nuclear (ex-Germany) and renewables.

Key data	Current
Price (€)	118.79
12 month price target (€)	152.00
Upside/(downside) (%)	28
Market cap (€ mn)	78,903.0
Enterprise value (€ mn)	85,303.8

	12/06	12/07E	12/08E	12/09E
Revenue (€ mn)	67,759.0	69,035.4	77,096.0	82,448.2
EBIT (€ mn)	7,744.0	8,279.5	10,173.6	11,588.0
EPS (€)	6.65	7.57	9.61	10.82
EV/EBITDA (X)	6.0	7.6	7.1	7.1
P/E (X)	14.0	15.6	12.4	11.0
Dividend yield (%)	3.6	3.4	4.2	4.8
FCF yield (%)	8.6	(4.1)	(17.4)	(2.2)
CROCI (%)	5.6	6.3	6.7	6.8
CROCI/WACC (X)	0.8	1.0	1.2	1.2
EV/GCI (X)	0.6	0.6	0.6	0.6

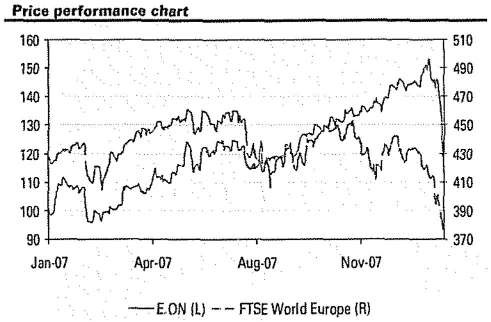
Valuation

Our €152 12-month SOTP is based on our assumption of €60/MWh for medium-term power prices for Central Europe. Our price target already reflects full auctioning of carbon permits across Europe from 2013 and €4 per share of further downside from regulatory/political intervention.

Key risks

The major risks to our price target for E.ON are lower commodity prices, political intervention and delivery of capex programme.

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	(9.6)	(3.0)	21.2
Rel. to FTSE World Europe	15.2	31.3	56.4

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 1/23/2008 close.

INVESTMENT LIST MEMBERSHIP

Pan-Europe Buy List

Coverage View: Neutral

Germany:
Power

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E.ON: Summary financials

Profit model (€ mn)	12/06	12/07E	12/08E	12/09E
Total revenue	67,759.0	69,035.4	77,096.0	82,448.2
Operating costs	(57,363.0)	(57,751.8)	(63,424.8)	(67,180.8)
R&D	0.0	0.0	0.0	0.0
Lease payments	0.0	0.0	0.0	0.0
Other operating profit/(expense)	551.0	0.0	0.0	0.0
EBITDA	**10,947.0**	**11,283.6**	**13,671.2**	**15,267.4**
Depreciation & amortisation	(3,203.0)	(3,004.1)	(3,497.6)	(3,679.4)
EBIT	**7,744.0**	**8,279.5**	**10,173.6**	**11,588.0**
Net interest income/(expense)	(1,081.0)	(989.6)	(1,691.4)	(2,257.7)
Associates	957.0	1,000.0	1,100.0	1,210.0
Profit/(loss) on disposals	0.0	0.0	0.0	0.0
Others (recurring)	(551.0)	0.0	0.0	0.0
Pretax profits	**7,069.0**	**8,289.9**	**9,582.2**	**10,540.2**
Income tax	(2,156.5)	(2,553.7)	(2,845.7)	(3,130.2)
Tax rate (%)	30.5	30.8	29.7	29.7
Minorities	(526.0)	(600.0)	(633.0)	(679.9)
Preferred dividends	0.0	0.0	0.0	0.0
Net income (pre-exceptionals)	**4,386.5**	**5,136.1**	**6,103.5**	**6,730.1**
Other non-recurring items post tax	670.5	1,313.5	(70.3)	(70.3)
Net income	**5,057.0**	**6,449.6**	**6,033.2**	**6,659.8**
EPS (underlying) (€)	**6.65**	**7.86**	**9.61**	**10.82**
EPS (basic, reported) (€)	7.67	9.87	9.50	10.71
Weighted shares outstanding (mn)	659.4	653.7	634.9	621.9
Common dividends declared	2,318.2	2,656.9	3,191.5	3,670.2
DPS (€)	3.35	4.00	5.00	5.75
Dividend payout ratio (%)	50.4	50.9	52.0	53.1
Dividend cover (X)	2.0	2.0	1.9	1.9

Growth & margins (%)	12/06	12/07E	12/08E	12/09E
Revenue growth	20.1	1.9	11.7	6.9
EBITDA growth	16.6	3.1	21.2	11.7
EBIT growth	20.1	6.9	22.9	13.9
Net income growth	(31.7)	27.5	(6.5)	10.4
EPS growth	19.4	18.1	22.4	12.6
DPS growth	21.8	19.4	25.0	15.0
EBITDA margin	16.2	16.3	17.7	18.5
EBIT margin	11.4	12.0	13.2	14.1

Cash flow statement (€ mn)	12/06	12/07E	12/08E	12/09E
Net income	4,386.5	5,136.1	6,103.5	6,730.1
D&A	3,203.0	3,004.1	3,497.6	3,679.4
Minority interest	526.0	600.0	633.0	679.9
Other recurring items	(200.5)	663.8	655.4	649.4
Post tax cash flow from operations	**7,915.0**	**9,404.0**	**10,889.5**	**11,738.8**
Net inc/(dec) working capital	(2,053.0)	(94.7)	(543.6)	(564.6)
Capital expenditures	(3,083.0)	(4,200.0)	(5,251.3)	(5,283.5)
Acquisitions	(2,078.0)	(7,800.0)	(16,800.0)	(6,000.0)
Divestitures	3,954.0	963.0	0.0	0.0
Dividends paid (common & pref)	(4,856.0)	(2,412.2)	(2,729.6)	(3,351.5)
Other non-recurring items	1,332.0	(4,250.0)	(4,250.0)	(750.0)
Surplus/(deficit)	**1,131.0**	**(8,390.0)**	**(18,685.0)**	**(4,210.7)**
Capex/D&A (%)	96.3	139.8	150.1	143.6
Reinvestment rate (%)	39.0	44.7	48.2	45.0
Cash flow cover of dividends (X)	3.6	3.6	3.4	3.3
Free cash flow cover of dividends (X)	2.4	(1.2)	(4.1)	(0.5)

Balance sheet (€ mn)	12/06	12/07E	12/08E	12/09E
Cash & equivalents	13,131.0	13,131.0	13,131.0	13,131.0
Accounts receivable	9,756.0	10,146.2	10,501.4	10,868.9
Stocks	3,990.0	4,189.5	4,378.0	4,575.0
Other current assets	15,126.0	15,126.0	15,126.0	15,126.0
Current assets	**42,003.0**	**42,592.7**	**43,136.4**	**43,700.9**
Accounts payable	(5,305.0)	(5,800.0)	(5,800.0)	(5,800.0)
Other current liabilities	(7,011.0)	(7,011.0)	(7,011.0)	(7,011.0)
Current liabilities	**(12,316.0)**	**(12,811.0)**	**(12,811.0)**	**(12,811.0)**
Gross PP&E and intangibles	117,741.0	130,159.0	152,210.3	163,493.8
Net PP&E	42,712.0	52,125.9	70,679.7	78,283.8
Net intangibles	18,873.0	18,873.0	18,873.0	18,873.0
Total investments	21,358.0	21,358.0	21,358.0	21,358.0
Other long-term assets	429.0	429.0	429.0	429.0
Long-term assets	**83,372.0**	**92,785.9**	**111,339.7**	**118,943.8**
Total assets	**125,375.0**	**135,378.7**	**154,476.1**	**162,644.7**
Unfunded pensions & other provs	(31,977.0)	(31,958.3)	(31,934.0)	(31,903.7)
Deferred taxes & other liabilities	(16,928.0)	(16,928.0)	(16,928.0)	(16,928.0)
Long-term liabilities	**(48,905.0)**	**(48,886.3)**	**(48,862.0)**	**(48,831.7)**
Total shareholders' equity	**47,845.0**	**48,624.4**	**48,670.1**	**52,220.4**
Minority interest	4,917.0	5,275.0	5,666.0	6,103.9
Short-term debt	1,469.0	1,469.0	1,469.0	1,469.0
Long-term debt	9,923.0	18,313.0	36,998.0	41,208.7
Capitalised leases	0.0	0.0	0.0	0.0
Capital employed	**64,154.0**	**73,681.4**	**92,803.1**	**101,002.1**
Adj for unfunded pensions & GW	(15,104.0)	(15,396.7)	(15,705.5)	(16,031.3)
Adj capital employed	**49,050.0**	**58,284.7**	**77,097.5**	**84,970.8**
Gross cash invested	**155,655.0**	**168,167.7**	**190,762.7**	**202,610.8**

Ratios	12/06	12/07E	12/08E	12/09E
CROCI (%)	5.6	6.3	6.7	6.8
CROCI/WACC (X)	0.8	1.0	1.2	1.2
ROIC (%)	7.2	8.7	8.9	8.7
ROIC/WACC (X)	1.0	1.4	1.5	1.6
ROA (%)	3.5	3.9	4.2	4.2
WACC (%)	7.1	6.2	5.8	5.6
Inventory days	21.5	22.2	20.7	20.3
Asset turnover (X)	1.6	1.3	1.1	1.1
Net debt/equity (%)	(3.3)	12.3	46.6	50.7
EBITDA interest cover (X)	10.1	11.4	8.1	6.8

Valuation	12/06	12/07E	12/08E	12/09E
EV/sales (X)	1.0	1.3	1.3	1.3
EV/EBITDAR (X)	6.3	7.7	7.3	7.2
EV/EBITDA (X)	6.3	7.7	7.3	7.2
EV/EBIT (X)	8.8	10.5	9.8	9.5
P/E (X)	14.0	15.0	12.4	11.0
Dividend yield (%)	3.6	3.4	4.2	4.8
FCF yield (%)	8.6	(4.1)	(17.4)	(2.2)
EV/GCI (X)	0.6	0.6	0.6	0.6
EV/adj. capital employed (X)	2.5	2.4	1.9	1.8
Price/book (X)	1.5	2.0	1.6	1.5

Note: Last actual year may include reported and estimated data

Source: Company data, Goldman Sachs Research estimates

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Exhibit 1: E.ON 12-month SOTP

(EUR mn)

Business segment	EBITDA 2008E	EV	Implied multiple	Valuation assumptions
CENTRAL EUROPE	5.916	60.059	10 2x	DCF, WACC 7%, Beta: 0 8, LT growth: 0 25%
PAN EURO GAS	2.329	24.320	10 4x	DCF, WACC 7%. Beta: 0 8. LT growth: 1%
E ON UK	2.084	14.474	6 9x	£250 per customer , £450 per MW plus RABs at 40% premium
OGK-4	169	4.325	25 6x	Value based on GS OGK-4 GSf price target $0 135/share
Southern Europe	1.599	11.500	7 2x	Estimated value of Spanish/Italian assets
NORDIC	1.384	14.904	10 8x	DCF, WACC 7%. Beta: 0 8, LT growth: 0 5%
US Midwest	544	4.621	8 5x	Average sector EBITDA multiple of 8 5x
Holding costs	-354	-3.394	9.6x	Apply Group multiple
Total group EV	**13,671**	**130,810**	**9.6x**	
Net debt		-27,343		2008E Net debt
Participations not including Gazprom, treasury shares		9,228		2008E Book value less Gazprom book value of € 11 9bn
6.4% Gazprom stake		11,353		Estimated after tax market value assuming 10% cap gains tax
Unrecognized value of 16 4mn treasury shares		1,934		Estimated market value assuming EON can resolve tax issues
Minorities		-5.666		2008E Book value
Pension, nuclear and other provisions		-20.737		2008E Book value
Total adjustments		**-31,231**		
Total equity value		**99,579**		
Implied price per share (EUR)		**156**		
Reflecting €4 for intervention risk		**152**		

Note: OGK-4 (Neutral, covered by Dmitry Trembovolsky): 12-month price target is DCF-based, key risks are drawback in power price liberalisation, execution risk on investment projects and cost control

Source Company data, Goldman Sachs Research estimates

Exhibit 2: E.ON: Summary financials

EURmn

Year to December	2005	2006	2007E	2008E	2009E	2010E	2011E	CAGR 06-11%
Profit and loss account								
Total revenues	56,399	67,759	69,035	77,096	82,448	84,147	87,659	5.3%
Operating expenses	(47,010)	(56,812)	(57,752)	(63,425)	(67,181)	(67,698)	(70,115)	4.3%
EBITDA - reported	**10,271**	**11,353**	**12,284**	**14,771**	**16,477**	**17,780**	**18,945**	10.8%
EBITDA - adjusted	**9,389**	**10,947**	**11,284**	**13,671**	**15,267**	**16,449**	**17,545**	9.9%
Depreciation	(2,939)	(3,203)	(3,004)	(3,498)	(3,679)	(3,803)	(3,945)	4.3%
EBITA	**6,450**	**7,744**	**8,280**	**10,174**	**11,588**	**12,646**	**13,599**	11.9%
Goodwill amortisation	0	0	0	0	0	0	0	n.m
Associate/other income	882	957	1,000	1,100	1,210	1,331	1,400	7.9%
Net financial expense	(1,634)	(1,605)	(990)	(1,691)	(2,258)	(2,471)	(2,554)	9.7%
Pre-exceptional PBT	**5,698**	**7,096**	**8,290**	**9,582**	**10,540**	**11,506**	**12,445**	11.9%
Exceptionals/extraordinaries	3,930	(1,809)	1,323	(100)	(100)	(100)	(100)	-44.0%
Profit before tax	**7,207**	**5,133**	**9,707**	**9,482**	**10,440**	**11,406**	**12,345**	19.2%
Tax	(2,276)	323	(2,563)	(2,816)	(3,100)	(3,387)	(3,666)	n.m.
Minorities	(553)	(526)	(600)	(633)	(680)	(732)	(791)	8.5%
Reported group net income	7,406	5,057	6,450	6,033	6,660	7,286	7,888	9.3%
Clean group net income (ex exceptionals)	3,673	4,386	4,951	6,104	6,730	7,356	7,958	12.7%
EBG (clean group, pre-goodwill)	3,673	4,386	4,951	6,104	6,730	7,356	7,958	12.7%
Balance sheet								
Tangible assets	41,323	42,712	52,126	70,680	78,284	86,463	89,348	15.9%
Investments/intangibles	41,174	47,175	47,175	47,175	47,175	47,175	47,175	0.0%
Fixed assets	**82,497**	**89,887**	**99,301**	**117,855**	**125,459**	**133,638**	**136,523**	8.7%
Cash and cash equivalents	15,119	6,187	6,187	6,187	6,187	6,187	6,187	0.0%
Other current assets	28,946	31,158	31,748	32,291	32,856	33,442	34,051	1.8%
Total assets	**126,562**	**127,232**	**137,236**	**156,333**	**164,502**	**173,267**	**176,761**	6.8%
Current liabilities	11,393	12,316	12,811	12,811	12,811	12,811	12,811	0.8%
Other liabilities	18,842	18,785	18,785	18,785	18,785	18,785	18,785	0.0%
Gross capital employed (including cash)	**96,327**	**96,131**	**105,640**	**124,737**	**132,906**	**141,671**	**145,165**	8.6%
Provisions	33,862	31,977	31,958	31,934	31,904	31,867	31,823	-0.1%
Short and long term debt	13,247	11,392	19,782	38,467	42,678	47,279	46,267	32.4%
Shareholders' Equity	*44,484*	*47,845*	*48,624*	*48,670*	*52,220*	*55,930*	*59,931*	4.6%
Minority interests	4,734	4,917	5,275	5,666	6,104	6,594	7,144	7.8%
Total liabilities	**126,562**	**127,232**	**137,236**	**156,333**	**164,502**	**173,267**	**176,761**	6.8%
Cash flow								
EBIT	6,450	7,744	8,280	10,174	11,588	12,646	13,599	11.9%
Depreciation	2,939	3,203	3,004	3,498	3,679	3,803	3,945	4.3%
Change in working capital	(4,253)	(2,053)	(95)	(544)	(565)	(586)	(609)	-21.6%
Non cash items/other	3,634	(2,288)	(808)	(850)	(850)	(850)	(850)	-18.0%
Dividends received from assoc./JVs	882	957	1,000	1,100	1,210	1,331	1,400	7.9%
Interest	(775)	(692)	(258)	(966)	(1,538)	(1,758)	(1,848)	21.7%
Tax	*(2,276)*	323	*(2,563)*	*(2,816)*	*(3,100)*	*(3,387)*	*(3,666)*	*n.m.*
Operating cash flow	**6,601**	**7,194**	**8,559**	**9,596**	**10,424**	**11,198**	**11,972**	10.7%
Capex	(2,990)	(3,083)	(4,200)	(5,251)	(5,284)	(4,981)	(4,630)	8.5%
Acquisitions	(1,347)	(2,078)	(7,800)	(16,800)	(6,000)	(7,000)	(2,200)	1.1%
Divestments	6,599	3,954	963	0	0	0	0	n.m.
Free cash flow (post interest/pre-dividends)	**8,863**	**5,987**	**(2,478)**	**(12,455)**	**(859)**	**(784)**	**5,141**	-3.0%
Dividends	(1,794)	(4,856)	(2,412)	(2,730)	(3,351)	(3,818)	(4,129)	-3.2%
Financing/Other	0	(2,192)	(3,500)	(3,500)	0	0	0	n.m.
Change in cash (net debt) at year end	**7,069**	**(1,061)**	**(8,390)**	**(18,685)**	**(4,211)**	**(4,601)**	**1,012**	-199.1%
Net debt at year end	**(793)**	**268**	**8,658**	**27,343**	**31,554**	**36,155**	**35,143**	165.2%

Source. Company data, Goldman Sachs Research estimates

Exhibit 3: Divisional split for operating earnings

€ mn

Adjusted EBITDA	**2006**	**2007E**	**2008E**	**2009E**	**2010E**	**2011E**	**2012E**	**2013E**
Central Europe	5.626	6,063	5,916	6.720	7,003	7.030	7.439	7.352
Nordic	991	1,151	1.384	1,707	1,938	2,027	2.188	2,186
Pan-European Gas	2,356	2,216	2.329	2.400	2,405	2,569	2.512	2.621
UK - Powergen	1,784	1,642	2.084	2.323	2,503	2.656	2,729	2,488
OGK-4			169	271	684	1,277	1,454	1,477
Southern Europe			1.599	1,622	1,650	1,677	1,696	1.715
US - Midwest	569	515	544	585	632	679	727	737
Real-Estate	0	0	0	0	0	0	0	0
Other	-379	-303	-354	-360	-366	-370	-370	-370
Group	**10,947**	**11,284**	**13,671**	**15,267**	**16,449**	**17,545**	**18,375**	**18,205**
Reported EBITDA	**2006E**	**2007E**	**2008E**	**2009E**	**2010E**	**2010E**	**2010E**	**2010E**
Nominal								
Central Europe	5,484	6,343	6,224	7,071	7.403	7,464	7,887	7,814
Nordic	992	1,151	1.384	1,707	1.938	2.027	2.188	2,186
Pan-European Gas	2,839	2,881	3.011	3.138	3,203	3,395	3,324	3.419
UK - Powergen	1.790	1,667	2.111	2.353	2,537	2.691	2,764	2,523
OGK-4			169	271	684	1,277	1,454	1,477
Southern Europe			1,599	1,622	1,650	1.677	1.696	1.715
US - Midwest	590	535	566	609	658	707	755	765
Other	-342	-293	-293	-293	-293	-293	-293	-293
Group	**11,353**	**12,284**	**14,771**	**16,477**	**17,780**	**18,945**	**19,775**	**19,605**

Source: Company data, Goldman Sachs Research estimates

Reg AC

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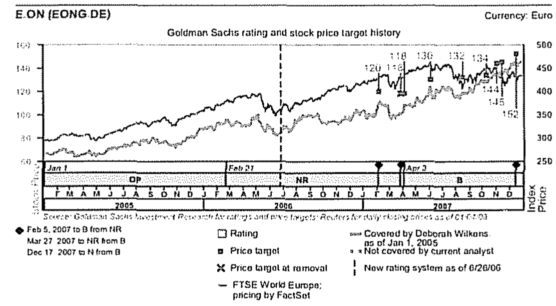

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