Notes

Notes

Notes

ANALYST CERTIFICATIONS

Each research analyst identified on page 1 hereof certifies that all of the views expressed in this report by such analyst accurately reflect his or her personal views about the subject securities and issuers In addition, each research analyst identified on page 1 hereof hereby certifies that no part of his or her compensation was, is, or will be, directly or indirectly related to the specific recommendations or views that he or she has expressed in this research report, nor is it tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

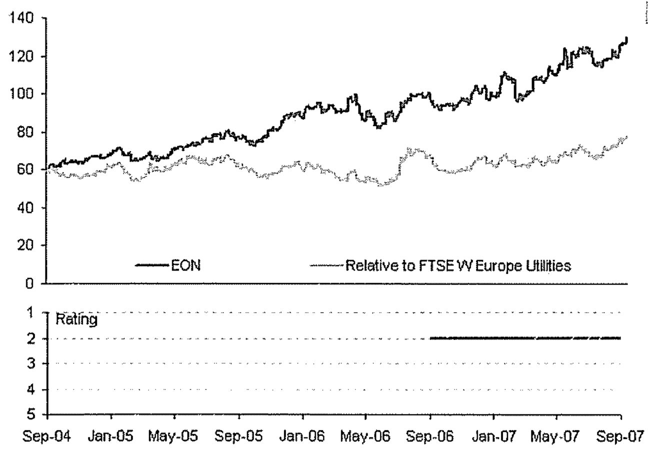
ISSUER SPECIFIC REGULATORY DISCLOSURES

Issuer	Ticker	Price (as at last close)	Closing Price Date	Rating	Disclosures
E ON	EOA GR	132.80 EUR	01 Nov 2007	Buy	

Previous Ratings

Issuer	Previous Rating	Date of change
E.ON	Initiation	26 Sep 2006

Three-year stock price and rating history



Date	Rating	Price (E)
26-Sep-06	2	94.09

Distribution of Nomura ratings / investment banking relationships

		Buy (a)	Neutral/Hold	Sell (b)
Nomura International plc	% of ratings published during the preceding quarter	45	40	15
	% for which material IB services (c) have been provided	1	4	0
Nomura Securities Co Ltd.	% of companies under coverage with this rating	41	54	5
	% for which IB services (c) have been provided	5	3	3
Nomura International (Hong Kong) Ltd.	% of companies under coverage with this rating	60	28	6
	% for which IB services (c) have been provided	2	1	0

Sources: Nomura International plc, Nomura Securities Co. Ltd and Nomura International (Hong Kong) Ltd. as at 30 September 2007.

(a) Buy includes the rating of Strong buy=1 and Buy=2

(b) Sell includes the rating of Reduce=4 and Sell=5

(c) IB services include (1) lead or co-lead management by Nomura International plc, Nomura Securities Co. Ltd. or Nomura International (Hong Kong) Ltd., as applicable, in the past 12 months of any publicly disclosed offer of the relevant company's securities or related derivatives, and/or (2) the provision by Nomura International plc, Nomura Securities Co. Ltd or Nomura International (Hong Kong) Ltd , as applicable, of investment banking services pursuant to an agreement with the relevant company which has been in effect over the past 12 months and which has given rise during the same period to payment or the promise of payment.

Explanation of Nomura's equity research rating system:

Stocks:

• A rating of "1", or **"Strong buy"**, indicates that the analyst expects the stock to outperform the Benchmark by 15% or more over the next six months.

- A rating of "2", or **"Buy"**, indicates that the analyst expects the stock to outperform the Benchmark by 5% or more but less than 15% over the next six months
- A rating of "3", or **"Neutral"**, indicates that the analyst expects the stock to either outperform or underperform the Benchmark by less than 5% over the next six months.
- A rating of "4", or **"Reduce"**, indicates that the analyst expects the stock to underperform the Benchmark by 5% or more but less than 15% over the next six months
- A rating of "5", or **"Sell"**, indicates that the analyst expects the stock to underperform the Benchmark by 15% or more over the next six months.
- Stocks labeled **"Not rated"** or shown as **"No rating"** are not in Nomura's regular research coverage. Nomura might not publish additional research reports concerning this company, and it undertakes no obligation to update the analysis, estimates, projections, conclusions or other information contained herein.

Sectors:

A **"Bullish"** stance, indicates that the analyst expects the sector to outperform the Benchmark during the next six months.

A **"Neutral"** stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next six months.

A **"Bearish"** stance, indicates that the analyst expects the sector to underperform the Benchmark during the next six months.

Benchmarks are as follows: **Japan**: TOPIX; **United States**: S&P 500 (except as shown below); **Europe**, by sector — *Hardware/Semiconductors*: FTSE W Europe IT Hardware; *Telecoms*: FTSE W Europe Business Services; *Business Services*: FTSE W Europe; *Auto & Components*: FTSE W Europe Auto & Parts; *Communications equipment*: FTSE W Europe IT Hardware; **Ecology Focus:** Bloomberg World Energy Alternate Sources; **Global Emerging Markets:** MSCI Emerging Markets ex-Asia.

Explanation of Nomura rating system for Asian companies under coverage ex Japan:

Stocks:

Stock recommendations are based on absolute valuation upside (downside), which is defined as (Fair Value - Current Price) / Current Price, subject to limited management discretion. In most cases, the Fair Value will equal the analyst's assessment of the current intrinsic fair value of the stock using an appropriate valuation methodology such as Discounted Cash Flow or Multiple analysis etc. However, if the analyst doesn't think the market will revalue the stock over the specified time horizon due to a lack of events or catalysts, then the fair value may differ from the intrinsic fair value. In most cases, therefore, our recommendation is an assessment of the difference between current market price and our estimate of current intrinsic fair value. Recommendations are set with a 6-12 month horizon unless specified otherwise. Accordingly, within this horizon, price volatility may cause the actual upside or downside based on the prevailing market price to differ from the upside or downside implied by the recommendation.

- A "**Strong buy**" recommendation indicates that upside is more than 20%.
- A "**Buy**" recommendation indicates that upside is between 10% and 20%
- A "**Neutral**" recommendation indicates that upside or downside is less than 10%.
- A "**Reduce**" recommendation indicates that downside is between 10% and 20%
- A "**Sell**" recommendation indicates that downside is more than 20%.

Sectors:

A "**Bullish**" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a positive absolute recommendation.

A "**Neutral**" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a neutral absolute recommendation.

A "**Bearish**" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a negative absolute recommendation.

Previous Nomura rating system for Asian companies under coverage ex Japan:

Stocks:

- A rating of "1", or "**Strong buy**," indicates that the analyst expects the stock to outperform the Benchmark by 15% or more over the next six months.
- A rating of "2", or "**Buy**," indicates that the analyst expects the stock to outperform the Benchmark by 5% or more but less than 15% over the next six months.
- A rating of "3", or "**Neutral**," indicates that the analyst expects the stock to either outperform or underperform the Benchmark by less than 5% over the next six months.
- A rating of "4", or "**Reduce**," indicates that the analyst expects the stock to underperform the Benchmark by 5% or more but less than 15% over the next six months

• A rating of "5", or "**Sell,**" indicates that the analyst expects the stock to underperform the Benchmark by 15% or more over the next six months

• Stocks labeled **"Not rated"** or shown as **"No rating"** are not in Nomura's regular research coverage. Nomura might not publish additional research reports concerning this company, and it undertakes no obligation to update the analysis, estimates, projections, conclusions or other information contained herein.

Sectors:

A "**Bullish**" stance, indicates that the analyst expects the sector to outperform the Benchmark during the next six months.

A "**Neutral**" stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next six months.

A "**Bearish**" stance, indicates that the analyst expects the sector to underperform the Benchmark during the next six months.

Benchmarks are as follows: **Asia**, by region and class of stock — **Australia**: ASX All Ordinaries Index; **China**: Hang Seng Index; **Hong Kong**: *Hang Seng Index, Hang Seng China Affiliated Corp Index, Hang Seng China Enterprises Index, HK Growth Enterprises Index*; **Indonesia**: Jakarta Composite Index; **Korea**: Korea Composite Index, Kosdaq Composite Index; **Malaysia**: Kuala Lumpur Comp Index, Kuala Lumpur 2nd Board; **Singapore**: STI Index; **Taiwan**: Weighted Index, Taiwan Gre Tai Securities Market Index; **Thailand**: Stock Exchange of Thailand.

Three-year stock price and rating history charts of NSI-rated stocks

For three-year daily stock-price and rating history charts of NSI-rated stocks, current as of the last calendar quarter and showing a distribution of investment ratings on all subject securities by rating category and investment banking relationship, please contact J. Funayama, US Equity Sales Desk, Nomura Securities International, Inc., 2 World Financial Center, Building B, New York, New York 10281, Telephone: 212-667-9556, E-mail: jfunayama@us.nomura.com.

Price targets

Price targets, if discussed, reflect in part the analyst's estimates for the company's earnings. The achievement of any price target may be impeded by general market and macroeconomic trends, and by other risks related to the company or the market, and may not occur if the company's earnings fall short of estimate.

Additional conflict of interest information

Important disclosures concerning investment banking relationships and other potential conflicts-of-interest involving certain other companies that are mentioned in, but are not a subject company of, this report are available through the following website: **http://www.nomura.com/research/Disclosures/public/main.asp**. If you have difficulty with this site or you do not have a password, please contact your Nomura Securities International, Inc., salesperson (1-877-865-5752) or email researchportal@nomura.co.uk for assistance

Online availability of research and additional disclosures

Nomura Japanese Equity Research is available electronically for clients in the US on NOMURA.COM, REUTERS, BLOOMBERG and THOMSON ONE ANALYTICS. For clients in Europe, Japan and elsewhere in Asia it is available on NOMURA.COM, REUTERS and BLOOMBERG. For information, contact your Nomura registered representative. Important disclosures required in the United States, EU and other jurisdictions may be accessed through the following website: **http://www.nomura.com/research/Disclosures/public/main.asp**. *If you have difficulty with this site* or you do not have a password, please contact your Nomura salesperson (for Nomura Securities International, Inc., 1-877-865-5752) or email researchportal@nomura.co.uk

DISCLAIMERS

This publication contains material that has been prepared by the Nomura entity identified on the banner at the top of page 1 herein and, if applicable, with the contributions of one or more Nomura entities whose employees and their respective affiliations are specified on page 1 herein or elsewhere identified in the publication. Affiliates and subsidiaries of Nomura Holdings, Inc. (collectively, the "Nomura Group"), include: Nomura Securities Co., Ltd. ("NSC") and Nomura Research Institute, Ltd., Tokyo, Japan; Nomura International plc and Nomura Research Institute Europe, Limited, United Kingdom; Nomura Securities International, Inc. ("NSI") and Nomura Research Institute America, Inc., New York, NY; Nomura International (Hong Kong) Ltd., Hong Kong; Nomura Singapore Ltd., Singapore; Nomura Australia Ltd., Australia; P.T. Nomura Indonesia, Indonesia; Nomura Malaysia Sdn. Bhd., Malaysia; Nomura International (Hong Kong) Ltd., Taipei Branch, Taiwan; or Nomura International (Hong Kong) Ltd., Seoul Branch, Korea.

This material is: (i) for your private information, and we are not soliciting any action based upon it; (ii) not to be construed as an offer to sell or a solicitation of an offer to buy any security in any jurisdiction where such offer or solicitation would be illegal; and (iii) based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon as such.

Opinions expressed are current opinions as of the original publication date appearing on this material only and the information, including the opinions contained herein, are subject to change without notice. If and as applicable, NSI's investment banking relationships, investment banking and non-investment banking compensation and securities ownership (identified in this report as "Disclosures Required in the United States"), if any, are specified in disclaimers and related disclosures in this report. In addition, other members of the Nomura Group may from time to time perform investment banking or other services (including acting as advisor, manager or lender) for, or solicit investment banking or other business from, companies mentioned herein. Further, the Nomura Group, and/or its officers, directors and employees, including persons, without limitation, involved in the preparation or issuance of this material may, to the extent permitted by applicable law and/or regulation, have long or short positions in, and buy or sell, the securities (including ownership by NSI, referenced above), or derivatives (including options) thereof, of companies mentioned herein, or related securities or derivatives. In addition, the Nomura Group, excluding NSI, may act as a market maker and principal, willing to buy and sell certain of the securities of companies mentioned herein Further, the Nomura Group may buy and sell certain of the securities of companies mentioned herein, as agent for its clients

Investors should consider this report as only a single factor in making their investment decision and, as such, the report should not be viewed as identifying or suggesting all risks, direct or indirect, that may be associated with any investment decision

NSC and other non-US members of the Nomura Group (i.e., excluding NSI), their officers, directors and employees may, to the extent it relates to non-US issuers and is permitted by applicable law, have acted upon or used this material prior to, or immediately following, its publication.

Foreign currency-denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of, or income derived from, the investment. In addition, investors in securities such as ADRs, the values of which are influenced by foreign currencies, effectively assume currency risk

The securities described herein may not have been registered under the U.S. Securities Act of 1933, and, in such case, may not be offered or sold in the United States or to U.S. persons unless they have been registered under such Act, or except in compliance with an exemption from the registration requirements of such Act. Unless governing law permits otherwise, you must contact a Nomura entity in your home jurisdiction if you want to use our services in effecting a transaction in the securities mentioned in this material.

This publication has been approved for distribution in the United Kingdom and European Union as investment research by Nomura International plc ("NIPlc"), which is authorised and regulated by the U.K. Financial Services Authority ("FSA") and is a member of the London Stock Exchange. It does not constitute a personal recommendation, as defined by the FSA, or take into account the particular investment objectives, financial situations, or needs of individual investors. It is intended only for investors who are "eligible counterparties" or "professional clients" as defined by the FSA, and may not, therefore, be redistributed to retail clients as defined by the FSA. This publication may be distributed in Germany via Nomura Bank (Deutschland) GmbH, which is authorised and regulated in Germany by the Federal Financial Supervisory Authority ("BaFin"). This publication has been approved by Nomura International (Hong Kong) Ltd. ("NIHK"), which is regulated by the Hong Kong Securities and Futures Commission, for distribution in Hong Kong by NIHK. Neither NIPlc nor NIHK hold an Australian financial services licence as both are exempt from the requirement to hold this license in respect of the financial services either provides. This publication has also been approved for distribution in Singapore by Nomura Singapore Limited. NSI accepts responsibility for the contents of this material when distributed in the United States.

No part of this material may be (i) copied, photocopied, or duplicated in any form, by any means, or (ii) redistributed without the prior written consent of the Nomura Group member identified in the banner on page 1 of this report. Further information on any of the securities mentioned herein may be obtained upon request. If this publication has been distributed by electronic transmission, such as e-mail, then such transmission cannot be guaranteed to be secure or error-free as information could be intercepted, corrupted, lost, destroyed, arrive late or incomplete, or contain viruses. The sender therefore does not accept liability for any errors or omissions in the contents of this publication, which may arise as a result of electronic transmission. If verification is required, please request a hard-copy version.

Additional information available upon request.

NIPlc and other Nomura Group entities manage conflicts identified through the following: their Chinese Wall, confidentiality and independence policies, maintenance of a Stop List and a Watch List, personal account dealing rules, policies and procedures for managing conflicts of interest arising from the allocation and pricing of securities and impartial investment research and disclosure to clients via client documentation.

Disclosure information is available at the Nomura Disclosure site

http://www.nomura.com/research/Disclosures/public/main.asp

Dresdner Kleinwort

Company update

20 November 2007

Buy

Unchanged

Current	€137.1
Target	**€152.0**
Previous	€139.0

Current price equivalent
US$202.8

Market cap
€94,880m
US$140,347m

52-week high/low
€137.1/€94.7

Price performance	1M	3M	12M
Price (€)	131 5	118 8	98 1
Absolute (%)	4 3	15 4	39 8
Rel market (%)	11 4	17.3	41 0
Rel sector (%)	3.1	2.5	17.2
EPS change	**1M**	**3M**	**12M**
EPS FY1 (%)	-3 2	-3 2	-14 4
IBES EPS (%)	2 2	1.7	7 8
Sector EPS (%)	0.0	-1 2	3 2
Market EPS (%)	0.0	-0.9	1.8

Source: DKIB Research, Thomson IBES

Reuters	Bloomberg
EONG.F	EOA GR Equity

E.ON

Putting cash to work

Despite having spent most of its discretionary capex, reinvestment risk is slow to disappear, as is shown by the big discounts to the sector E.ON continues to trade at. E.ON does not yet get full credit for the value of its Gazprom stake nor its growth profile or its earnings quality. We believe this will change in '08. We raise our PT to €152.

- **Period of consolidation.** Following its €7bn share buy-back and the acquisition of assets from Enel/Acciona (for an EV "estimated to be in excess of €10bn"), OGK-4, various renewables (Energi E2, Airtricity) and gas (Skarv-Idun), E.ON is set to achieve its targeted balance sheet structure of 3x net debt/EBITDA (consistent with A / A2 rating) already in 2008. We do not believe that E.ON's rating is currently factoring in that it could be about to enter a period of consolidation.

- **To €12.4bn and beyond!** We believe that E.ON will comfortably achieve its aim of 10% compound EBIT growth to 2010. Even on its existing assets alone E.ON will almost achieve this aim (€11.7bn, 8.7% avg EBIT growth), but including all acquisitions that should be completed by the end of '08, E.ON will comfortably surge past its €12.4bn EBIT target (we forecast €14.4bn, 14.5% avg EBIT growth).

- **Sluggish consensus.** We believe that consensus earnings are slow to recognise the earnings power that results from E.ON putting its cash to work. Our '08 forecast for recurring EPS of €9.94 is only 10% above consensus estimates, but by 2010 this gap widens to a lively 40%. So in an environment where '08 could see significant downward revisions to earnings estimates, E.ON's earnings are likely to go up.

- **Great value.** Gearing up the balance sheet has reduced the discount to the sector in terms of forward EV/EBITDA from around 15% to 10% ('08 EV/EBITDA is distorted by acquisitions), while the PE discount to the sector has widened. Even on normal recurring '09 EPS E.ON is trading at a 26% discount to the sector. Adjusting this PE for the value of E.ON's 6.4% stake in Gazprom (taxed), drops the '09 PE to below 10x – a 35% discount to the sector.

- **Target price.** Strong cash flow generation, a higher rating for the sector, a better than expected performance from the Central European division and – yet again – Pan-European Gas divisions and the effect of E.ON's share buy-back lift our sotp from €139 to **€152**. This fair value target still assumes the same c. €60/MWh nominal electricity price (€55/MWh real) we have assumed since July this year.

Year to end Dec	EBITDA EUR m	Rec EPS EUR	P/E x	DPS EUR	Yield %	Net debt/ EBITDA x	FCF Yield %	P/CF x	EV/EBITDA x
2006	11,789	6 65	20 6	3.35	2.4	1 5	3 3	12 6	8 9
2007E	12,709	7 46	18.4	4 10	3 0	2 0	3 4	10 1	8 6
2008E	15,397	9 94	13 8	5 50	4 0	3 0	1 4	8 0	8 6
2009E	17,822	12 11	11 3	6.70	4 9	2 6	5 3	6 5	7.5

Source: Company data, Dresdner Kleinwort Research estimates

Research Analysts
Lueder Schumacher
+44 (0)20 7475 2491
lueder schumacher@dkib com

Please refer to the Disclosure Appendix for all relevant disclosures and our disclaimer.

Putting cash to work

Following publication of 9m numbers and the kind of deal flow that would keep other companies busy for years (see below) we have updated our numbers. We have also adjusted our forecasts for the likely impact of the German tax reform, which will see the nominal corporate tax burden (corporation and trade tax) decline from c. 39% to about 30% from January 2008.

- **2 Aug 2007:** Skarv-Idun gas fields in Norway (€650m, plus €1bn development capex)
- **7 Aug 2007:** Energi E2 Renovables Ibéricas (€722m, plus €600m development capex)
- **15 Sep 2007:** OGK-4 (€4.1bn for a 69.34% stake, completed 15 Oct)
- **4 Oct 2007:** Airtricity wind farms in North America ($1,373m, plus $3.5bn development capex to 2011)
- **12 Oct 2007:** E.ON Sverige minority buy-out (€4.4bn for 44.6% stake)

E.ON divisional EBITDA forecasts

(€m)	2006 A	2007 F	2008 F	2009 F	2010 F	2011 F	2006 – 11 (%)
Central Europe	5,747	6,609	7,078	7,548	7,904	7,848	6.4
Endesa Europe		0	822	1,778	1,894	2,029	
Pan-European Gas	3,092	3,173	3,476	3,632	3,735	3,875	4.6
UK	1,804	1,625	2,048	2,375	2,438	2,575	7.4
Nordic	936	1,120	1,201	1,344	1,306	1,327	7.2
OGK-4		60	165	330	844	1,356	
E ON Renewables		0	458	634	784	932	
US-Midwest	595	527	547	568	590	613	0.6
Corporate Centre/Consolidation	(385)	(405)	(396)	(388)	(380)	(373)	
EBITDA (IFRS)	**11,789**	**12,709**	**15,397**	**17,822**	**19,115**	**20,182**	**11.4**
excl. new acquisitions	11,789	12,649	13,952	15,080	15,593	15,865	6.1

Source: Dresdner Kleinwort Research estimates

E.ON divisional EBIT (IFRS) forecasts

(€m)	2006 A	2007 F	2008 F	2009 F	2010 F	2011 F	2006 – 11 (%)	2006 – 10 (%)
Central Europe	4,235	5,027	5,437	5,847	6,138	6,014		
Endesa Europe	0	0	555	1,232	1,392	1,519		
Pan-European Gas	2,347	2,512	2,581	2,721	2,807	2,930	4.5	
UK	1,239	1,131	1,530	1,842	1,890	2,012		
Nordic	512	701	774	910	864	877		
OGK-4		9	92	225	716	1,218		
E ON Renewables			326	454	565	677		
US-Midwest	426	351	365	380	395	411		
Corporate Centre/Consolidation	(403)	(437)	(428)	(420)	(411)	(403)		
EBIT (IFRS)	**8,356**	**9,294**	**11,232**	**13,191**	**14,356**	**15,254**	**12.8**	**14.5**
excl. new acquisitions	8,356	9,285	10,259	11,281	11,682	11,841	7.2	8.7
			"10 until 10"		12.400			

Source: Dresdner Kleinwort Research estimates

Target (May '07): "10 until 10": E.ON will increase its adjusted EBIT by 10% pa on average until 2010

Central Europe and Ruhrgas continue to perform strongly

Our forecast for group EBITDA and adj. EBIT remain largely unchanged for '07 and '08, with lower earnings from E.ON UK, Nordic and US-Midwest being offset by a better performance form Central Europe and Ruhrgas. Post 2009 the new acquisitions (OGK-4, renewables) start to make their presence felt. The newly consolidated businesses are also responsible for the 12% and 22% rise in our forecast for 2009/10 recurring EPS.

E.ON Forecast changes

(€m)	2006	2007	2008	2009	2010
EBITDA (old)	11,353	12,626	15,532	16,643	16,931
EBITDA (new)	11,789	12,709	15,397	17,822	19,115
Change (%)		**0.7**	**(0.9)**	**7.1**	**12.9**
Adj. EBIT (old)	8,233	9,342	11,718	12,756	13,023
Adj. EBIT (new)	8,356	9,294	11,232	13,191	14,356
Change (%)		**(0.5)**	**(4.1)**	**3.4**	**10.2**
Stated EPS (old)	7.67	8.04	9.41	10.83	11.13
Stated EPS (new)	7.67	9.69	10.28	12.41	13.84
Change (%)		**20.5**	**9.3**	**14.6**	**24.4**
Recurring EPS (old)	6.65	7.54	9.41	10.83	11.13
Recurring EPS (new)	6.65	7.46	9.94	12.11	13.59
Change (%)		**(1.0)**	**5.6**	**11.8**	**22.1**
DPS (old)	3.35	4.10	5.20	6.00	6.10
DPS (new)	3.35	4.10	5.50	6.70	7.50
Change (%)		**0.0**	**5.8**	**11.7**	**23.0**

Source: Dresdner Kleinwort Research estimates

Consensus estimates are slow to reflect E.ON's speed of acquisitions

It appears that consensus forecast are slow to catch-up with E.ON's break-neck speed of putting its cash to work. It seems unlikely that 2009/10 consensus forecasts already reflect the acquisition of OGK-4, Endesa Europe/Viesgo or the recent renewables assets. These mean together with the impact of the German tax reform, where the utilities are likely to be less impacted by the refinancing measures than previously thought, leave consensus with some catching-up to do.

Dresdner Kleinwort vs. consensus

(€m)	2006	2007	2008	2009	2010
EBITDA (DK)	11,789	12,709	15,397	17,822	19,115
EBITDA (consensus)	11,353	12,070	13,608	14,737	14,565
Dresdner Kleinwort vs. consensus (%)		**5.3**	**13.1**	**20.9**	**31.2**
Adj. EBIT (DK)	8,356	9,294	11,232	13,191	14,356
Adj. EBIT (consensus)	8,233	8,873	9,940	10,754	11,111
Dresdner Kleinwort vs. consensus (%)		**4.7**	**13.0**	**22.7**	**29.2**
Stated EPS (DK)	7.67	9.69	10.28	12.41	13.84
Stated EPS (consensus)	7.67	7.95	8.99	9.93	9.71
Dresdner Kleinwort vs. consensus (%)		**21.9**	**14.3**	**25.0**	**42.5**
Recurring EPS (DK)	6.65	7.46	9.94	12.11	13.59
Recurring EPS (consensus)	6.65	7.89	9.02	9.80	9.71
Dresdner Kleinwort vs. consensus (%)		**(5.4)**	**10.2**	**23.5**	**40.0**
DPS (DK)	3.35	4.10	5.50	6.70	7.50
DPS (consensus)	3.35	3.91	4.62	5.20	5.45
Dresdner Kleinwort vs. consensus (%)		**4.9**	**19.2**	**28.8**	**37.6**

Source: Dresdner Kleinwort Research estimates

E.ON continues to trade at a big discount to the sector

This leaves E.ON trading at 13.8x '08 earnings – a 15% discount to the sector. For '09 the discount even widens to 26%, and that's before making any adjustment for the value of E.ON's 6.4% stake in Gazprom. The stake is currently worth some €13bn, some 13.5% of E.ON's current market cap, but contributes hardly anything to E.ON's earnings. Adjusting the PE for the taxed value of the Gazprom stake sees the '08 PE fall to 12.1x, a 26% discount to the sector, and the '09 PE to 9.9x, a 35% discount.

Gearing up has reduced E.ON's EV/EBITDA discount to the sector, but widened the PE discount

As expected, gearing up the balance sheet has reduced the discount to the sector in terms of forward EV/EBITDA from around 15% to 10%, while the PE discount to the sector has widened. The '08 EV/EBITDA of 8.6% shows only a 4.3% discount to the sector, but this is a reflection of acquisitions being fully reflected in the EV, but only from mid-year in the EBITDA. The '09 discount of 10% is a better reflection, but can't be justified given E.ON's earnings growth outlook and earnings quality.

E.ON key Ratios

@ €137	2006 A	2007 F	2008 F	2009 F	2010 F	2011 F
EPS (€) (recurring)	6.65	7.46	9.94	12.11	13.59	14.78
P/E (x)	20.6	18.4	13.8	11.3	10.1	9.3
P/E (adj. for Gazprom stake) (x)	18.1	16.1	12.1	9.9	8.9	8.2
DPS (€)	3.35	4.10	5.50	6.70	7.50	8.10
Yield (%)	2.4	3.0	4.0	4.9	5.5	5.9
Payout ratio (%)	50.3	54.9	55.4	55.3	55.2	54.8
CFPS (€)	10.91	13.59	17.06	21.19	22.95	24.10
P/CF (x)	12.6	10.1	8.0	6.5	6.0	5.7
BVPS (€)	72.59	81.35	90.80	99.61	106.76	114.25
P/BV (x)	1.9	1.7	1.5	1.4	1.3	1.2
EV / EBITDA	8.9	8.6	8.6	7.5	6.9	6.4
Free cash flow yield (%)	3.3	3.4	1.4	5.3	7.7	8.6
		Type	**Splitt**	**Tax**		**Adj. price**
Adjusted for Gazprom stake:	12,970	ADR	7,093	142	83,386	**120.50**
		Russia	5,877	1,411	11,418	
	Price ($)	**Shares**	**MV ($m)**	**$/€**		
	50.00	5,918.38	**295,919**	**1.4670**	**201,717**	**12,970**

Source: Dresdner Kleinwort Research estimates

E.On rating relative to European utility sector

	2006 A	2007 F	2008 F	2009 F	2010 F	2011 F
P/E sector (16 Nov 2007) (x)	23.7	18.8	16.3	15.3		
P/E E.ON (x)	20.6	18.4	13.8	11.3		
Premium / (discount) to sector (%)	**(13.1)**	**(2.4)**	**(15.4)**	**(26.1)**		
P/E E.ON (adjusted for Gazprom, taxed) (x)	18.1	16.1	12.1	9.9		
Premium / (discount) to sector (%)	**(23.6)**	**(14.1)**	**(25.6)**	**(35.0)**		
EV/EBITDA sector (16 Nov 2007) (x)	10.7	9.9	9.0	8.3		
EV/EBITDA E.ON (x)	8.9	8.6	8.6	7.5		
Premium / (discount) to sector (%)	**(16.7)**	**(13.6)**	**(4.3)**	**(9.8)**		

Source: Dresdner Kleinwort Research estimates

We increase our price target for E.ON to €152

Strong cash flow generation, a higher rating for the sector, a better than expected performance from the Central Europe and – yet again – Pan-European Gas divisions and the effect of E.ON's share buy-back lift our sotp from €139 to **€152**. This fair value target still assumes the same c. €60/MWh nominal (€55/MWh real) electricity prices we have assumed since July this year.

E.ON's exposure to cuts in CO_2 certificates is limited

E.ON's earnings show a greater quality than RWE due to its more efficient generation portfolio which is less CO_2 intensive. As with RWE, we assume that E.ON's fulfilment factor for Phase III will be cut by 50% vs. Phase II, leading to a Phase III factor of 25%. Cutting this to 0% in a 100% auctioning scenario (and ignoring the effect this would have on power prices) would see E.ON's sotp drop by about 2% or €3 per share. For RWE the same assumption would lead to a 10% decline in the fair value target, or almost €11 per share.

E.ON Sum-of-the-parts

	2009 EBITDA	EV/EBITDA (x)	EV	Debt & provisions	Minorities	Equity for E.ON	Method
Central Europe	7,548	8.4	63,233	(16,487)	(2,722)	44,024	DCF
Endesa Europe	1,778	8.3	14,758	0	(2,500)	12,258	Multiple
Pan-European Gas	3,632	8.3	30,147	(1,000)	(289)	28,858	Multiple
UK	2,375	8.3	19,715	(7,200)	(63)	12,452	Multiple
Nordic	1,344	8.3	11,158		Bought out	11,158	Multiple
OGK-4	330	17.9	5,913		(1,813)	4,100	Invested cap
E.ON Renewables	634	10.0	6,320			6,320	Invested cap
US-Midwest	568	8.3	4,717		(78)	4,639	Multiple
Other / Consolidation	(388)	8.3	(3,223)	(33,461)	(67)	(36,751)	Multiple
Group	**17,822**		**152,738**	**(58,149)**	**(7,532)**	**87,057**	
	17,822						
Shares in unconsolidated affiliates						0	
Shares in associated companies						8,143	
Other share investments						12,096	
Long-term securities						6,963	
Net debt & EBITDA definition, others						(15,663)	
Equity valuation (€m)						**98,596**	
Shares						647.36	
Value per share (€)						**152.31**	
Price target (€)						**152.31**	

Other adjustments				
Adj. for participations in EBITDA		Multiple		
2009	1,051	8.3	8,726	(8,726)
Adj. for E.ON's net debt definition				(4,937)
Treasury shares to Statkraft				(2,000)
Total				(15,663)

Debt & provisions	2009 F
Net debt	29,625
Pension provisions	3,997
Total debt	**33,621**

	Book value	(%)	
Nuclear	13,487	100	13,487
Tax	4,043	0	0
Personnel	1,578	75	1,183
Bad debts - procurement	3,355	75	2,516
Bad debts - sales contracts	289	75	216
US regulatory liabilities	524	75	393
Environmental remediation	562	75	422
Land reclamation	1,908	75	1,431
Miscellaneous	3,484	50	1,742
Total other provisions	**29,231**		**21,392**
Reversal of provisions			7,840
Tax (@ 40%)			3,136
Net			4,704
Total adjustment			**24,528**

Source: Dresdner Kleinwort Research estimates

Assumption:
E ON will consolidate Endesa Europe and selected Spanish assets - combined EV of €11 65bn - from 1 July 2008

E.ON Outlook, Nov 2007:
2007 EBIT + "5-10%"
E ON Outlook, May 2007:
2007 EBIT to "surpass" '06

E.ON target:
10% compound EBIT growth to 2010
("10 by 10")
=> 2010 EBIT of €12 4bn

Low tax rate due to:
higher tax-exempt earnings
€1 279m from first time recognition of corporate tax credits
€1 2bn from deferred tax benefits as a result of losses from marking-to-market of energy derivatives

E ON Outlook, Nov 2007:
Improvement in adj NI "comparable to rise in adj EBIT" => + "5-10%"

Dividend policy:
- payout ratio of 50-60%
- avg growth of 10-20%

E.ON Nov 2007:
9m Cash from operating operations +61% to €7.223m

Fixed asset investments 2007-09: €19.7bn
(vs Dec '06 investment plan of €22.4bn)

E.ON Nov 2007:
9m Free cash flow +63% to €3.128m

E.ON Nov 2007:
Net debt of €1.291m FY net debt/EBITDA around 2.1-2 3x

E.ON could achieve targeted net debt/EBITDA of 3-3.5x already in 2008 (target rating of single flat A/A2)

E.ON - Summary

Year to end December (€m)	2006	2007E	2008E	2009E	2010E	2011E	2012E		
Sales	67,759	74,139	82,976	89,840	93,513	96,896	99,988		
Total income	72,429	79,021	87,870	94,863	98,705	102,227	105,502		
- Operating costs	51,560	56,777	62,462	66,530	68,554	70,457	72,626		
- Other	9,080	9,534	10,011	10,511	11,037	11,589	12,168		
EBITDA	11,789	12,709	15,397	17,822	19,115	20,182	20,708		
								2007	2006
Depreciation	3,433	3,415	4,164	4,631	4,759	4,928	5,069	- 12 (%)	- 10 (%)
EBIT (IFRS)	**8,356**	**9,294**	**11,232**	**13,191**	**14,356**	**15,254**	**15,639**	**11.0**	**14.5**
% change		**11.2**	**20.9**	**17.4**	**8.8**	**6.3**	**2.5**	Target:	10
Net financial	(1,287)	(981)	(1,568)	(1,807)	(1,672)	(1,530)	(1,269)		
Extraordinaries	(1,936)	1,270	0	0	0	0	0		
Profit Before Tax	5,133	9,583	9,665	11,384	12,684	13,724	14,370		
Tax	323	(2,631)	(2,783)	(3,318)	(3,719)	(4,036)	(4,225)		
Profit After Tax	5,456	6,952	6,882	8,066	8,965	9,688	10,145		
Minorities	(526)	(593)	(501)	(521)	(547)	(570)	(595)		
Net Income (con't. operations)	4,930	6,359	6,381	7,545	8,418	9,119	9,550		
Discontinued operations	127	(94)	0	0	0	0	0		
Changes in accounting principle	0	0	0	0	0	0	0		
Net Income	**5,057**	**6,265**	**6,381**	**7,545**	**8,418**	**9,119**	**9,550**		
Adjustment	(544)	(1,535)	(213)	(181)	(154)	(131)	(111)		
Recurring Net Income	4,386	4,824	6,168	7,364	8,265	8,988	9,439		
Shares	659.15	646.38	620.83	608.06	608.06	608.06	608.06		
EPS (€) - Stated	**7.67**	**9.69**	**10.28**	**12.41**	**13.84**	**15.00**	**15.71**	**2007 – 12 (%)**	
EPS (€) - Recurring	**6.65**	**7.46**	**9.94**	**12.11**	**13.59**	**14.78**	**15.52**	**15.8**	
% change		12.2	33.1	21.9	12.2	8.8	5.0	**2007 – 12 (%)**	
DPS (€) (Ordinary dividend)	**3.35**	**4.10**	**5.50**	**6.70**	**7.50**	**8.10**	**8.50**	**15.7**	
Payout (%)	50.3	54.9	55.4	55.3	55.2	54.8	54.8	**2007 – 12 (%)**	
EPS (€)–Recur- pre Endesa assets		**7.46**	**9.42**	**10.95**	**12.28**	**13.35**	**13.95**	**13.3**	
% enhancement			5 5	10 6	10.7	10 7	11 3		
Summary cash flow (€m)								**2007 – 12 (%)**	
Operating Cash Flow	**7,194**	**8,785**	**10,589**	**12,887**	**13,958**	**14,656**	**15,109**	**11.5**	
CFPS	**10.91**	**13.59**	**17.06**	**21.19**	**22.95**	**24.10**	**24.85**		
Core Capex	(4,083)	(5,586)	(9,223)	(7,840)	(6,647)	(6,498)	(5,020)		
Financial capex	(1,078)	(11,403)	(18,800)	(1,600)	(900)	(900)	0		
Disposals	2,023	300	0	0	0	0	0		
Disposals (equity accounted assets)	3,651	684	0	0	0	0	0		
Dividend (previous year)	(1,813)	(2,208)	(2,598)	(3,344)	(4,074)	(4,560)	(4,925)		
Free cash flow post divs & inv.	5,894	(9,428)	(20,031)	103	2,337	2,698	5,164		
								2007 – 12 (%)	
Free cash flow pre dividends	**3,111**	**3,199**	**1,366**	**5,047**	**7,311**	**8,158**	**10,089**	**25.8**	
Free cash flow yield (%)	3.3	3.4	1.4	5.3	7.7	8.6	10.6		
Summary balance sheet (€m)									
Fixed Assets	96,344	109,618	133,477	138,285	141,073	143,544	143,495		
Current Assets	30,888	31,594	33,938	35,088	38,233	41,948	48,328		
Total Assets	127,232	141,212	167,415	173,373	179,307	185,492	191,822		
Shareholders' Funds	52,762	57,503	61,286	65,486	69,831	74,389	79,013		
Current Liabilities	27,196	37,637	58,584	59,362	59,935	60,509	61,123		
Provisions	24,175	22,972	24,446	25,426	26,442	27,495	28,587		
Long-term liabilities	23,099	23,099	23,099	23,099	23,099	23,099	23,099		
Equity & Liabilities	127,232	141,212	167,415	173,373	179,307	185,492	191,822		
BVPS	72.59	81.35	90.80	99.61	106.76	114.25	121.86		
Stated net debt / (cash)	**268**	**9,696**	**29,727**	**29,625**	**27,288**	**24,590**	**19,427**		
Pension/nuclear provisions	17,531	16,150	17,131	17,600	18,086	18,589	19,111		
Rating net debt / (cash)	**17,799**	**25,846**	**46,858**	**47,225**	**45,374**	**43,179**	**38,537**		
Net debt / EBITDA (x)	1.5	2 0	3 0	2.6	2 4	2 1	1.9		
Net Gearing (stated net debt) (%)	0.6	18 4	52.7	48 9	42 0	35 4	26 2		

Source: Company data, DKIB Equity research estimates

Disclosure appendix

Disclosures under US regulations

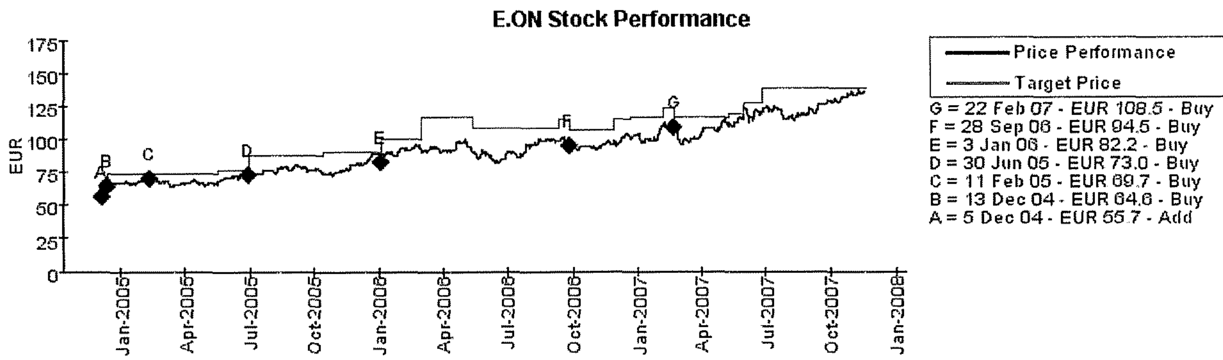
A current or former member of the Supervisory Board or Board of Managing Directors of Allianz SE or Dresdner Bank AG or an employee of Dresdner Bank AG and/or its subsidiaries is a member of Aufsichtsrat of E.ON. Dresdner Kleinwort or an affiliate has received compensation from E.ON for non-investment banking securities services in the past 12 months. Dresdner Kleinwort or an affiliate has received compensation from E.ON for non securities services in the past 12 months. Dresdner Kleinwort or an affiliate has a beneficial interest in 1% or more of the equity of E.ON. Dresdner Kleinwort or an affiliate has received compensation from E.ON for investment banking services in the past 12 months.

The relevant research analyst(s), as named on the front cover of this report, certify that (a) all of the views expressed in this research report accurately reflect their personal views about the securities and companies mentioned in this report; and (b) no part of their compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or views expressed by them contained in this report.

Any forecasts or price targets shown for companies and/or securities discussed in this report may not be achieved due to multiple risk factors including without limitation market volatility, sector volatility, corporate actions, the unavailability of complete and accurate information and/or the subsequent transpiration that underlying assumptions made by Dresdner Kleinwort or by other sources relied upon in the report were inapposite.

Recommendation history charts

Past performance is not an indicator of future performance.



Dresdner Kleinwort Research – Recommendation definition
(Except as otherwise noted, expected performance over next 12 months)

Buy:	10% or greater increase in share price	Sell:	10% or more decrease in share price
Add:	5-10% increase in share price	Reduce:	5-10% decrease in share price
Hold:	+5%/-5% variation in share price		

Distribution of Dresdner Kleinwort equity recommendations as of 30 Sep 2007

	All covered companies		Companies where a Dresdner Kleinwort company has provided investment banking services (in the last 12 months)	
Buy/Add	373	64%	116	31%
Hold	138	24%	25	16%
Sell/Reduce	69	12%	7	10%
Total	**580**		**148**	

Source: Dresdner Kleinwort Research

Additional disclosures under other non-US regulations

The disclosures under US regulations above should be read together with these additional disclosures. Dresdner Kleinwort or an affiliate regularly holds trading positions in the shares of E.ON.

In respect of any compendium report covering six or more listed companies, please refer to the following website for all relevant disclosures: www.dresdnerkleinwort.com/research/disclosures

Unless otherwise noted, the securities mentioned in this report are priced as of 20th November, 2007 at 11:00. Time given is local to the address shown at the bottom of the first page of this report.

Disclaimer

This report has been prepared by Dresdner Kleinwort, by the specific legal entity named on the cover or inside cover page.

United Kingdom: This report is a communication made, or approved for communication in the UK, by Dresdner Kleinwort Securities Limited (authorised and regulated by the Financial Services Authority and a Member Firm of the London Stock Exchange). It is directed exclusively to market counterparties and intermediate customers. It is not directed at private customers and any investments or services to which the report may relate are not available to private customers. No persons other than a market counterparty or an intermediate customer should read or rely on any information in this report. Dresdner Kleinwort Securities Limited does not deal for, or advise or otherwise offer any investment services to private customers.

European Economic Area: Where this report has been produced by a legal entity outside of the EEA, the report has been re-issued by Dresdner Kleinwort Securities Limited for distribution into the EEA. Dresdner Kleinwort Research GmbH is regulated by the Federal Financial Supervisory Authority ('BaFin') by the laws of Germany.

United States: Where this report has been approved for distribution in the US, such distribution is by either: (i) Dresdner Kleinwort Securities LLC; or (ii) other Dresdner Kleinwort companies to US Institutional Investors and Major US Institutional Investors only ; or (iii) if the report relates to non-US exchange traded futures, Dresdner Kleinwort Limited. Dresdner Kleinwort Securities LLC, or in case (iii) Dresdner Kleinwort Limited, accepts responsibility for this report in the US. Any US persons wishing to effect a transaction through Dresdner Kleinwort (a) in any security mentioned in this report may only do so through Dresdner Kleinwort Securities LLC, telephone: (+1 212) 429 2000; or (b) in a non-US exchange traded future may only do so through Dresdner Kleinwort Limited, telephone: (+ 11 44) 20 7623 8000; or (c) in a banking product may only do so through Dresdner Bank AG New York Branch, telephone (+1 212) 969 2700.

Singapore: This research report is being distributed for Dresdner Kleinwort in Singapore by Dresdner Bank AG, Singapore Branch, purely as a resource and for general informational purposes only, and is intended for general circulation. Accordingly, this research report does not take into account the specific investment objectives, financial situation, or needs of any particular person and is exempted from the same by Regulation 34 of the Financial Advisers Regulations ("FAR") (as required under Section 27 of the Financial Advisers Act (Cap. 110) of Singapore ("FAA")).

Hong Kong: This report is being distributed for Dresdner Kleinwort in Hong Kong by Dresdner Kleinwort Securities Limited. Unless permitted to do so by the securities laws of Hong Kong, no person may issue or have in its possession for the purposes of issue this report, whether in Hong Kong or elsewhere, which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong, other than with respect to the securities referred to in this report which are or are intended to be disposed of only to persons outside Hong Kong or only to "professional investors" within the meaning of the Securities and Futures Ordinance (Cap.571) of Hong Kong and any rules made thereunder, and to persons whose ordinary business is to buy and sell shares or debentures.

Japan: Where this report is being distributed in Japan, such distribution is by either (i) Dresdner Kleinwort (Japan) Limited Tokyo Branch (registered and regulated by the Financial Services Agency and General Trading Participant of TSE, Regular Transaction Participant and Transaction Participant in Futures Transaction of OSE, Participant of JASDAQ) to Japanese investors excluding private customers or (ii) other Dresdner Kleinwort companies, to entities falling within the proviso of the Article 58-2 of the Financial Instruments and Exchange Law (the "FIEL") and the Article 17-3 of the Enforcement Order for the FIEL. Any Japanese persons not falling within (ii) wishing to effect a transaction through Dresdner Kleinwort in any security mentioned in this report may only do so through Dresdner Kleinwort (Japan) Limited Tokyo Branch, telephone: (+ 813) 6230 6000.

Australia: Neither Dresdner Bank AG ("DBAG") nor Dresdner Kleinwort Securities Limited holds an Australian financial services licence. This report is being distributed in Australia to wholesale customers pursuant to an Australian financial services licence exemption for DBAG under Class Order 04/1313 or for Dresdner Kleinwort Securities Limited under Class Order 03/1099. DBAG is regulated by BaFin under the laws of Germany and Dresdner Kleinwort Securities Limited is regulated by the Financial Services Authority under the laws of the United Kingdom, both of which differ from Australian laws.

This report contains general information only, does not take account of the specific circumstances of any recipient and should not be relied upon as authoritative or taken in substitution for the exercise of judgment by any recipient. Each recipient should consider the appropriateness of any investment decision having regard to their own circumstances, the full range of information available and appropriate professional advice. The information and opinions in this report constitute judgment as at the date of this report, have been compiled or arrived at from sources believed to be reliable and in good faith (but no representation or warranty, express or implied, is made as to their accuracy, completeness or correctness) and are subject to change without notice. Dresdner Kleinwort may amend, supplement or update the contents of this report in such form and in such timescales as Dresdner Kleinwort deems appropriate. Recommendations and opinions herein reflect Dresdner Kleinwort's expectations over the 12 month period following publication from the perspective of long-only investment clients. Dresdner Kleinwort reserves the right to express different or contrary recommendations and opinions for different timescales or for other types of investment client. This report does not constitute or form part of, and should not be construed as, any offer for sale or subscription of, or any invitation to offer to buy or subscribe for, any securities, nor should it or any part of it form the basis of, or be relied on in any connection with, any contract or commitment whatsoever. Dresdner Kleinwort accepts no liability whatsoever for any loss or damage arising from any use of this report or its contents. Whilst Dresdner Kleinwort may provide hyperlinks to websites of entities mentioned in this report, the inclusion of a link does not imply that Dresdner Kleinwort endorses, recommends or approves any material on the linked page or accessible from it. Dresdner Kleinwort accepts no responsibility whatsoever for any such material, nor for any consequences of its use. This report is for the use of the addressees only, is supplied to

Equity Research

E.ON

Utilities / Germany

www.exanebnpparibas-equities.com

Update

EPS revisions	12/06	12/07e	12/08e	12/09e
Revised	7.46	8.43	9.29	10.53
Previous	7.46	8.43	8.99	10.46
% change	-	-	3	ns

21 November 2007

Stock vs Sector	**Outperform**
Sector vs Market	**Neutral**
Price (20 November 2007)	**EUR138.2**
Target price	**EUR151.0 (+9%)**

Market cap./Free float (EURbn)	84.8/78.4
EV (EURbn)	98.6
12-month high/low (EUR)	138.2/94.5
Reuters/Bloomberg	EONG.DE/EOA GY
DJ STOXX50	3,628.0
Risk rating	A

Per share data (EUR)	12/06	12/07e	12/08e	12/09e
EPS restated	7.46	8.43	9.29	10.53
EPS reported	7.67	11.28	9.91	10.96
EPS (IBES)	*7.48*	*7.90*	*8.91*	*10.09*
CFPS	12.18	16.13	15.99	17.85
Net dividend	3.35	3.85	4.43	5.09

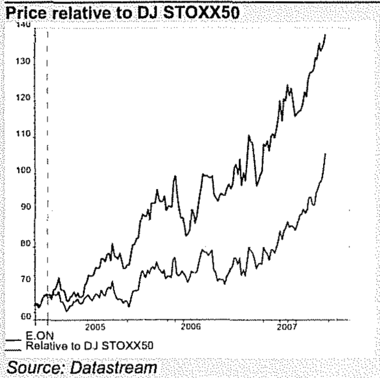
Stockmarket ratios*	12/06	12/07e	12/08e	12/09e
P/E (x)	12.5	16.4	14.9	13.1
P/E rel.DJ STOXX50 (%)	112.4	150.4	145.0	138.9
P/CF (x)	7.7	8.6	8.6	7.7
P/BV (x)	1.3	1.7	1.6	1.5
Net yield (%)	3.6	2.8	3.2	3.7
EV/Sales (x)	1.0	1.6	1.6	1.6
EV/EBITDA (x)	5.7	8.8	8.5	7.8
EV/EBIT (x)	8.6	12.0	11.8	10.5

** Yearly average price for FY ended 12/06*

P&L highlights (EURm)	12/06	12/07e	12/08e	12/09e
Sales	64,197	63,107	67,597	71,466
Restated EBIT	7,399	8,199	8,944	10,688
Attrib. net profit (adj.)	4,672	5,227	5,574	6,185

Performance (%)	1w	1m	3m	12m
Absolute	3	5	16	44
Rel. Utilities	2	4	3	21
Rel. DJ STOXX50	5	11	17	47

Price relative to DJ STOXX50



Source: Datastream

Please refer to important disclosures at the end of this report.

Piling up bricks on rock solid foundations

► **Once perceived aggressive EUR12.4bn adj. EBIT target totally within reach**

Thanks to faster delivery than expected on the investment programme (EUR18.9bn(e) acquisition spree in 2007-08 already identified), we believe E.ON needs no new acquisitions to reach its ambitious target of EUR12.4bn adjusted EBIT in 2010. We have revised our EPS by 3% on 2008e, 0.4% on 2009e and 4% on 2010e to reflect the contribution of the recently acquired companies, mostly in Russia, the US and Iberia.

► **Rerating not over as the risks remain limited**

The recent rerating (16% outperformance since January) has led E.ON's shares back to their 2003 highs (11x EV/EBITDA 07e). Management's commitment to integrating the newly acquired companies will turn the spotlight onto E.ON's excellent fundamentals. The perception of exposure to risk is still exaggerated: the prospect of government intervention on customer prices is entirely fanciful, and a one-year delay in liberalising Russia's electricity market would trim only EUR0.3/s off E.ON's share price.

► **Outperform rating reaffirmed, target price adjusted up to EUR151/s**

Our updated DCF-based SOP indicates a valuation of EUR151/share (slight upward adjustment from EUR147.6). E.ON still trades at a 4% discount to the sector on EV/EBITDA 08e (8.4x versus 8.8x), but the commitment to organic growth and exposure to activities with fast EBITDA growth (wind, Russia) justify a 3% premium, as implied by our SOP. We maintain our Outperform rating.

Benjamin Leyre

Benjamin Leyre
Paris: +33142992472
benjamin.leyre@exanebnpparibas.com

José Javier Ruiz Fernandez
London: +44 20 7039 9471
jjruiz@exanebnpparibas.com

Nicola Porcari, CFA
Paris: +33 1 42 99 52 43
nicola.porcari@exanebnpparibas.com

EXANE BNP PARIBAS

Investment Case

E.ON has outperformed the utilities sector by close to 16% since the beginning of the year. We believe that this rerating is attributable essentially to rapid delivery on the EUR60bn four-year investment plan announced in spring 2007 and is not yet over. E.ON is trading at 8.4x corrected EV/EBITDA 2008e (versus 8.8x for peers), whereas the inclusion of the Russian division (OGK4) and the newly acquired wind business, which both come with a structurally high EV/EBITDA 08e, merit a premium. More upside should come from the realisation that E.ON is exposed to these fast-growing activities.

Safe and Visible

E.ON is now entering a third phase of strategy focusing on integration and organic growth, after the failed attempt to acquire Endesa and the subsequent rebound, with a stream of acquisitions following the announcement of a EUR60bn four-year investment plan in April 2007.

Management's commitment to the integration of newly acquired companies will turn the spotlight onto the company's excellent fundamentals. E.ON has already acquired, or is known to be about to acquire, certain companies that will enable the group to easily reach EUR12.4bn of adjusted EBIT in 2010e.

We regard this as extremely reassuring: with a very clear and consistent message since the announcement of its EUR60bn four-year investment plan, the company has successfully striven to abide by its commitment. Management is now negotiating an inflection point, focusing on integrating its recently acquired companies through organic growth. Transparent management communication is paying off handsomely and should keep bringing support for share price performance.

Risks are manageable

We believe that the share price is still being held down by a perception of risk related to two factors:

- high exposure to political intervention in Germany,
- entry into the Russian electricity market, where the future shape of electricity regulation (especially the pace of liberalisation) has not yet been finalised.

We believe these risks are overstated.

- **In our view, German political intervention remains entirely fanciful.** While the announcement of an electricity price increase of close to 10% on 15 October triggered a political storm, the German government is not allowed to intervene on prices as long as abuse of dominant position is unproved, and we believe that price levels simply reflect fundamentals.
- The foray into the Russian market is adventurous indeed. However, any one-year delay in the pace of liberalisation would trim only EUR0.3/s off our sum-of-parts for E.ON.

Triggers still ahead

The triggers ahead are well known, but should nevertheless bode well for the company.

– **Mid-December:** the company is to provide an update on its EUR60bn four-year strategic plan. We expect the company to colour in its next steps and develop its thinking on the integration of recently acquired companies.

– **H1 2008:** Finalisation of the acquisition of Endesa, which will offer E.ON an entry into the French electricity market, strengthen its position in the Italian electricity market and give it a foothold in Spain. It will allow the company to optimise the usage of its power generating fleet across these countries and Germany.

– **Results and guidance:** We expect the company to provide solid guidance for 2008 when it releases its FY07 results. We believe the company can easily replicate its expected 2007 performance of 5-10% growth in adjusted EBIT in 2008. In fact, we estimate that it could do better, depending on the exact timing of the consolidation of Endesa's assets and of Viesgo (we currently expect 9% growth from 2007 to 2008, assuming that consolidation starts in July 2008, and we note that if the acquisition occurs sooner, as suggested by ENEL, it would add circa 0.8% to 2008e adjusted EBIT per additional month of consolidation).

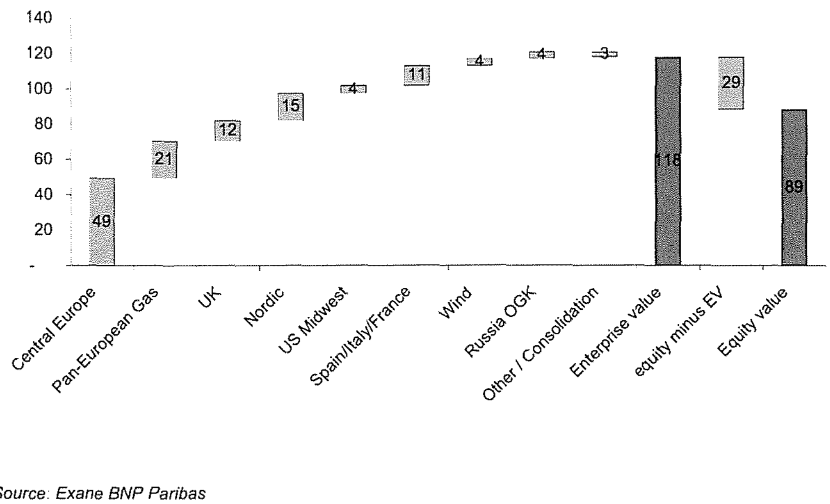
Target price adjusted upward to EUR151/share, Outperform maintained

The stock remains cheap, trading at 8.4x corrected EV/EBITDA 08e, below peers (8.8x), whereas it should trade at a 3% premium due to its exposure to fast EBITDA growth avenues in wind and Russia.

Our target price reflects our (slightly adjusted) sum-of-parts of EUR89bn, or EUR151/share.

The resulting significant upside to the current share price leads us to reiterate our Outperform recommendation.

Chart 1: Sum-of-parts for E.ON (EURbn)



Source: Exane BNP Paribas

100% of 2010 adjusted EBIT target already in E.ON's hands

We estimate that E.ON does not need any new acquisitions to reach its target of EUR12.4bn adjusted EBIT (the key metric published by E.ON to assess its operational profitability, essentially comprising operating profit and the contribution of equity accounted companies) by 2010e. This target should be reached thanks to the organic growth opportunities that will stem from integrating the recently acquired companies, like the wind activities of DONG in Iberia, Airtricity in the US and Russian power company OGK4.

Phase 3 in the strategy: delivering on organic growth

We identify three phases in E.ON's strategy over the past four years.

– **Phase 1,** until April 2007, was that of international (and domestic: Ruhrgas) growth through large acquisitions, while at the same time selling off non-energy-related businesses. The high-profile acquisition was one too many, and ultimately an unsuccessful attempt to purchase Endesa.

– **Phase 2,** until now, is that of **targeted, politically-supported, medium-size acquisitions,** in a rebound after the failed attempt to buy Endesa. The acquisition of DONG's wind assets, Airtricity in the US and OGK4 in Russia fit into this category. The strategy leverages the EUR60bn four-year investment plan presented in April 2007. All in all, the company will have spent EUR18bn on acquisitions in 2007 and 2008, or EUR9bn per year, compared with EUR1.7bn in 2004-06.

– **Phase 3,** about to start, is that of **consolidation**. At the 9M conference call on 13 November, management made it clear that the time is now ripe to integrate recently acquired business units and develop organic growth from them, though we would definitely not exclude the possibility of E.ON embarking on a new acquisition of significant size if the opportunity arises.

Potential acquisitions – Belgium, Spain, UK?

We note, however, that in the UK the company has more electricity customers than electricity production capacity. This may tempt the company to purchase power generating activities there.

Also, Spain could still be of interest, provided local politics do not get in the way (a big "if" which in our view could in any case not unfold until after the parliamentary elections in March 2008). Union Fenosa (Spain's third largest electricity utility with 7.1GW of installed generating capacity) would be a perfect fit for E.ON, since it would help the company achieve its stated ambition of getting into the top three in any country it invests in. Viesgo and the generation assets that ENEL and Endesa will be selling to E.ON in the first half of 2008 will not be enough to achieve this. We note that Union Fenosa still trades 11% below our stand-alone valuation of EUR51.9/s. As such, a move on Union Fenosa would in our view be well perceived. But again, the lack of political support in Spain makes such a move extremely unlikely in the short term.

The company is also likely to make an offer to exchange power generating assets in Germany for GDF-Suez's stake in gas company Distrigaz in **Belgium.** We think this would be warmly welcomed in Germany, as it could ease the political tension there by allowing GDF-Suez to grow in size in Germany, thus letting a fifth force develop in Germany's electricity sector (after RWE, E.ON, Vattenfall and EnBW). We estimate that Suez's stake in Distrigaz could be exchanged for 1.5-2GW of E.ON's gas- or coal-fired generating capacity in Germany. It is unlikely in our view that E.ON would part from its nuclear generating capacity, although it could offer access to capacity through contracts (replicating part of the swap deal they have announced with Statkraft).

A significant, well-timed inflection point in strategy

In the meantime, the focus on organic growth definitely marks an **inflection point,** suggesting that the time of medium to large acquisitions is now over (EUR18bn, or EUR9bn per year will have been spent on identified acquisitions in 2007 and 2008, compared with a yearly average of EUR1.7bn in 2004-06).

This should not really come as a surprise and we certainly appreciate that the management is spending some time rolling out an organic growth strategy.

Recent acquisitions boost financial expectations

We have made the following adjustments to our financial expectations.

– **Short term,** we are marginally increasing **2007e adjusted EBIT** by 2% to reflect minor adjustments following the 9M 2007 results. In particular, we are reducing the contribution from the UK division, which is likely to suffer more than expected from the price cuts that have taken place over the past few months. However, this is more than offset by an increase in the expected contribution from the Pan-European gas division, which the company is confident will grow strongly in 2007. Our 2007 forecasts are in line with the company's 2007 guidance of 5-10% growth in adjusted EBIT, at the top end of the range (+9% expected), as refined by management during the 9M results conference call.

– **Longer term,** our financial expectations now include the contribution of the assets to be obtained from ENEL/Endesa (circa EUR1bn/year of adjusted EBIT) as well as those deriving from the still-to-be-created wind division and power generation in Russia (OGK4).

– We are also revising the contribution from the Central Europe, Pan European Gas and Nordic divisions slightly downward from 2008 on to reflect the swap agreement announced between E.ON and Statkraft, whereby E.ON would sell a handful of power generation and heat assets to Statkraft in exchange for E.ON's purchase of the minorities of its Nordic division held by Statkraft.

Table 1: E.ON modification in adjusted EBIT (E.ON definition)

EURm	2006	2007e	2008e	2009e	2010e
Central Europe	4,235	4,851	4,662	5,618	5,825
Pan-European Gas	2,347	2,524	2,371	2,343	2,316
UK	1,239	1,016	1,056	1,077	1,151
Nordics	512	679	1,028	1,087	1,091
US Midwest	426	391	401	410	420
Spain/Italy/France	0	0	501	1,166	1,358
Wind	0	0	100	155	196
Russia OGK	0	0	141	201	389
Other / Consolidation	(403)	(285)	(291)	(297)	(303)
group adjusted EBIT	8,356	9,176	9,969	11,761	12,444
Previous	8,356	8,999	9,570	10,800	10,945
% change	0	2	4	9	14

Source: Exane BNP Paribas estimates

We note that our expectations are in line with the consensus in 2007 and 2008, but 4% above the consensus in 2009.

At the net income level, we are revising our financial expectations for the group upwards. These adjustments are the aggregate result of higher adjusted EBIT expectations, lower minorities from the Nordic division (gradually offset by increasing minorities from Russian power generation activities), but higher financial costs attributable to an increase in the expected net financial debt.

Table 2: Adjusted net income expectations

EURm	2006	2007e	2008e	2009e	2010e
Previous	4,672	5,157	5,235	5,942	6,293
New	4,672	5,227	5,574	6,185	6,825
% change	0	1	6	4	8

Source: Exane BNP Paribas estimates

Stand-alone valuation edged up to EUR151 share (from EUR147.8)

The recent strong stock performance and increase in implied trading multiples are largely attributable in our view to the skills management has deployed in delivering on its EUR60bn, four-year investment plan faster than anticipated.

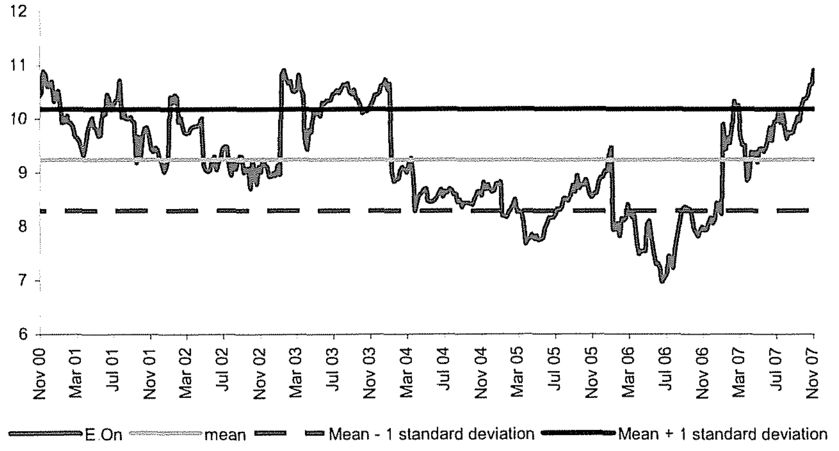
However, thanks to its exposure to the high EBITDA growth potential of wind activities and the Russian power sector, we believe that E.ON deserves to trade at a premium to peers.

EV/EBITDA and P/E multiples now far more reasonable

As a result of this achievement, E.ON's current-year EV/EBITDA multiple has increased steadily to levels not seen since 2003. The valuation gap with peers has essentially closed.

The following charts examine how the company's EV/EBITDA and P/E multiples have evolved over the past few years. They illustrate the rally that took place over the last year, attributable in our view to the stated strong commitment to deliver on the EUR60bn four-year investment plan and subsequent steady delivery.

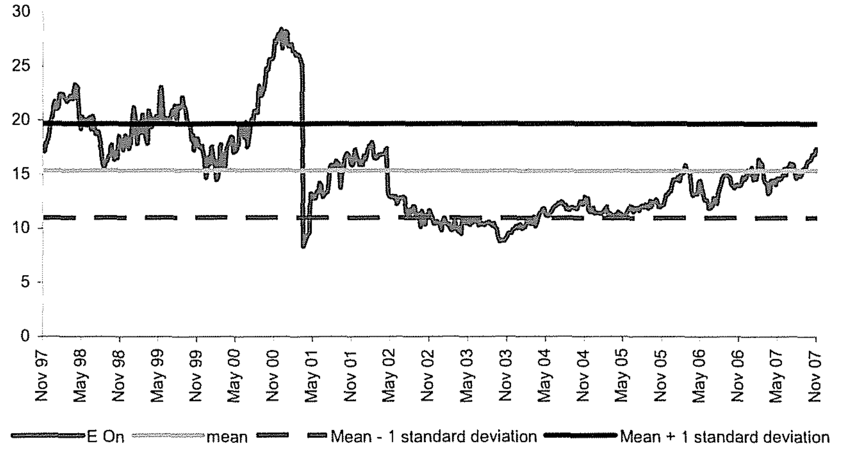
Chart 2: E.ON current year EV/EBITDA (based on consensus estimates)



Source: Exane BNP Paribas estimates

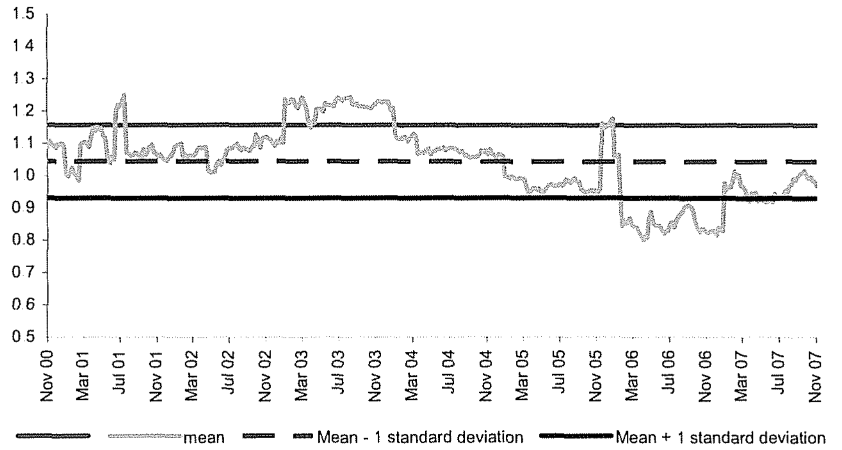
At the P/E level, the company is now trading at a premium to the last 10 years' historical current-year P/E. In relative terms we also note that, while the share price is trading at an implied current-year EV/EBITDA relative to the sector that is still 5% below its historical average distance from the utilities sector EV/EBITDA, the gap is significantly less than a year ago, when the discount amounted to 22%.

Chart 3: E.ON current year PE (based on consensus estimates)



Source: Exane BNP Paribas estimates

Chart 4: E.ON PE premium to sector versus history (based on consensus estimates)



Source: Exane BNPP Paribas estimates

Adjusting sum-of-parts marginally up to EUR151/s

E.ON is now trading at corrected EV/EBITDA 2008e of 8.4x, i.e., at a 4% discount to peers (8.8x). However, as our updated sum-of-parts suggests, we believe that a 3% premium would be more appropriate.

We have made a number of adjustments to our stand-alone valuation of E.ON:

- We are keeping the same presentation format for all existing divisions.
- We treat the contributions from the Russian and wind activities to E.ON's enterprise value separately (separate divisions are likely to be created for these two activities), as their economic drivers are clearly disconnected from those of the other divisions.
- We value E.ON's wind business at 20x EV/EBTIDA 08e. This is consistent with the valuation of Iberdrola's wind business and with our estimate of EDP's wind business.

In our assumptions, the activities to be purchased from ENEL and ENDESA contribute only from 1 July 2008. This is rather on the conservative side, as E.ON has said it expects to complete the transaction within H1 and ENEL has said it expects the price to be decided in Q1 2008. Our assumed purchase price is in line with its contribution to E.ON's valuation (EUR11.3bn EV), and consistent with the proceeds that we have assumed in ENEL's sum-of-parts. Conservatively, we have not yet included any synergy from the acquisition.

Lastly, the roll-over to 2008. This means in particular that estimated net debt at end-2008 includes the full impact of the two-year EUR7bn share buy-back programme and acquisitions already announced and to be completed throughout 2008 (acquisition of ENEL's Viesgo and of Endesa's assets). We note that plant valuation is still based on a long-term electricity price of EUR52/MWh (real), consistent with a USD55/bl long-term real Brent oil price.

Table 3: E.ON SOP

EURm	EV/ division	EV/ Segment	G'ration	N'work	Supply	Other	EV/EBITA 08e (x)	EV/EBIT 08e (x)	% of EV	EBITDA 2008e	EBIT 2008e	Method
Central Europe	**49,498**						**8.6**	**11.6**	**42**	**5,743**	**4,283**	
Generation		26,484	26,484.48						22			Plant-by-plant DCF
Supply		(2,079)			(2,079)							DCF
Electricity Networks		*16,819*		*16,819*					14			RAV-based EV/EBITDA
Total Power		41,224							35			
Gas distribution		3,580		3,580					3			DCF
East		3,272		3,272					3			DCF
Other		1,422				1,422			1			DCF
Pan European Gas	**20,963**						**9.2**	**11.8**	**18**	**2,285**	**1,777.0**	
Upstream		3,486				3,486			3			DCF
Transmission		10,124		10,124					9			RAV-based DCF
Total up/midstream		13,610							12			
Distribution		5,432		5,432					5			RAV-based DCF
Other		1,921				1,921			2			DCF
UK	**11,664**						**7.1**	**11.1**	**10**	**1,639**	**1,050.0**	
Generation		7,217	7,217						6			Plant-by-plant DCF
Supply		1,500			1,500				1			*Value per customer*
Total non-regulated		8,717							7			
Distribution		3,971		3,971					3			RAV-based DCF
Other		(1,024)				(1,024)			(1)			DCF
Nordic	**15,320**						**10.8**	**14.9**	**13**	**1,413**	**1,027**	
Generation		11,471	11,471						10			Plant-by-plant DCF
Distribution		3,849		3,849					3			DCF
US Midwest	**4,265**						**7.3**	**11.1**	**4**	**583**	**383**	**Consolidation assumed in July 2008**
US Midwest		4,265	2,559	1,706								DCF
Spain/Italy/France	**11,289**						**17.9**	**23.5**	**10**	**631**	**481**	
Spain/Italy/France		11,289	11,289									
Wind	**3,988**						**20.0**	**39.9**	**3**	**199**	**100**	
Wind		3,988	3,988									20x EV/EBITDA08e
Russia OGK	**3,795**						**21.8**	**26.9**	**3**	**174**	**141**	
Russia OGK		3,795	3,795									
Corporate	**(2,202)**						**9.3**	**9.2**	**(2)**	**(293)**	**(296)**	
Other		(2,202)				(2,734)						DCF
Total EV	**118,580**		**66,803**	**48,753**	**(579)**	**3,070**	**9.6**	13.3		**12,374**	8,946	
Gazprom stake	16,977											DCF
Other financial assets	8,807											
Net cash/(debt)	(29,086)											End-2008e
Provisions	(18,821)											
Other liabilities												
Minority interests	(8,028)											
Equity value	88,429											
No. of shares *(ex treasury) (m)*	587 2											Post share buy-back
Equity val./share (EUR)	150.6											

Source: Exane BNP Paribas estimates

On a simplified basis, we summarize E.ON's sum of parts in the table below.

Table 4: E.ON's simplified SOP

	EV (EURm)	Implied *EV/EBITDA08e*	EBITDA08e *(EURm)*	Risk	Opportunity
Central Europe	49,498	8 6	5,743	Fine for abuse of dominant position. Decrease in oil price	Further increase of wholesale electricity prices (valuation of power assets currently benchmarked against USD55/bl oil price assumption, or EUR52/MWh long term electricity price), or nuclear lifetime. Current generating assets value implies EUR815/kW, versus EUR1070/kW on average for utilities under our coverage, implying a discount justified by lower remaining lifetime because of nuclear law
Pan-European Gas	20,963	9 2	2,285	Competitive pressure on downstream margins	Higher gas price for upstream activities
UK	11,664	7 1	1,639	Further pressure on customer retail margins	Further consolidation to diminish competition level
Nordic	15,320	10 8	1,413	Unexpected outages of nuclear plants	Higher wholesale electricity prices
US Midwest	4,265	7 3	583	EUR/USD rate	EUR/USD exchange rate
Spain/Italy/France	11,289	17 9	631	Acquisition delayed by disagreement with ENEL on price	Potential integration synergies
Wind	3,988	20 0	199	Generous support schemes scaled down significantly	Support schemes provide boulevard for growth
Russia OGK	3,795	21 8	174	Slower liberalization than anticipated	Picking up the asset before the market liberalizes
Other / Consolidation	2,202	(7 5)	(293)		
Enterprise value	118,580	9 6	12,374		
Financial assets and associates	25,784				
Net debt, other liabs	(55,935)				
Equity value	88,429				

Source: Exane BNP Paribas estimates

Premium to peers is appropriate

Our sum-of-parts implies EV/EBITDA 2008e of 9.6x. Corrected for the fact that the assets from Endesa and Viesgo should contribute only as of July 2008, our SOP implies a corrected EV/EBITDA 2008e of 9.1x. This is 3% above peers (8.8x), European integrated utilities. Such a premium is justified in our view by the following factors:

– Margins in the Russian electricity sector are likely to widen between 2008 and 2011. Even if there is some delay in convergence on the cost of new power plants (see section on Russia), 2008 EBITDA is likely to be only a poor reflector of future EBTIDA (in this division, we expect 55% CAGR EBITDA growth between 2008 and 2011).

– We estimate that E.ON's recently acquired wind activities are valued at a high 20x EV/EBITDA 08e, in line with the valuation we are using for EDP's and Iberdrola's wind activities.

Potential upside from longer nuclear lifetime

It is well known already that under Germany's 2000 nuclear energy act, the lifetime of E.ON's 8.4GW nuclear reactors is limited to 32 years on average. We do not expect any change to this law before the elections to be held in autumn 2009. While it is too early in our view to reach a final judgment on whether the lifetime of nuclear plants will increase (this would require a new law reversing the previous one and not merely a government decision), we note that authorising E.ON's plants to run for 40 years rather than 32 would increase E.ON's EV by EUR13/s and diminish nuclear provisions by circa EUR3.9/s (by delaying the cash outflows related to nuclear plant decommissioning), giving a total positive impact on equity value of EUR17/s on top of our stand-alone value of EUR151/s.

Still exaggerated perception of risk exposure

While a significant part of the rerating of the stock has already occurred, we believe that investors still discount the share due to two major risks which we think are largely exaggerated.

– While the announcement by E.ON (and RWE) of upcoming electricity price increases in January 2008 has triggered a political storm, E.ON is protected from government intervention by European law, which guarantees market-based prices.

– Growing exposure to the Russian power market makes some investors increasingly uncomfortable. While the risk of short-term disappointment with the pace of liberalisation of the Russian power sector cannot be dismissed, we estimate that any one-year delay would trim only EUR0.3/s off E.ON's share price.

German politics is a factor but the risk of intervention is fanciful

The political temperature has risen dramatically in Germany following the announcement by E.ON and RWE of further electricity price increases in January 2008.

All in all, there has been more of a scare than any real harm. The political heat reached its highest when German economy minister Glos questioned the legitimacy of price increases. However, the pressure heat has since eased as more sensible legal considerations have taken over.

We believe it would be fanciful to suppose that electricity prices could be brought back under government control in Germany as the current law, which obviously complies with the second European electricity directive, does not allow for any such possibility.

The following table shows how events unfolded after the announced price increases. It is a very telling story, illustrating how the announcement of price increases led to a political outcry and threats of political intervention, but now looks likely to end up with the passing of legislation, already proposed, that shifts the burden of proof from the Cartel Office to the utilities (i.e. utilities will have to show that their price increases are fair, whereas in the current regulatory environment the Cartel Office is responsible for determining whether announced price increases indicate abuse of dominant position).

– 15 October 2007: Announcement of an almost 10% increase in electricity prices in January 2008.

– 17 October 2007: The Cartel Office announces it will examine RWE and E.ON price hikes. A German government spokesman says the utilities' price increases are "not justifiable".

– 18 October 2007: Chancellor Merkel says the Cartel Office must look into raised electricity prices. Merkel says competition authorities will soon be given more powers to punish abuse through rules proposed by Economy Minister Glos.

– 21 October 2007: Mr Glos says he has doubts on the legitimacy of price increases.

– 24 October 2007: Mr Glos says price hikes are unreasonable. He says the government's planned changes to the cartel law due to take effect on 1 January should help boost competition. Under the plan, companies will have to justify price increases rather than the Cartel Office having to prove that such price rises are unjustified, as is currently the practice. He presents these new rules to the Bundestag, the (elected) lower house of the German parliament, and rejects calls to break up utilities in an attempt to boost competition.

– 24 October 2007: European Energy Commissioner Piebalgs observes progress on the unbundling debate at the European level.

– 25 October 2007: European Competition Commissioner Kroes says German energy market is "rotten".

– 5 November 2007: The German State of Hesse plans to give the country's Cartel Office more powers to reduce the alleged dominance of Germany's largest power companies RWE and E.ON. The economy minister of Hesse, Rhiel, wants to give the Cartel Office the right to force utilities to sell power plants. Rhiel is working on a draft law to be put to the upper house of the German parliament in Berlin (Bundesrat, appointed), where Germany's 16 states are represented. The bill will be presented in early 2008.

– 5 November 2007: Energy companies reject Der Spiegel's report of price-fixing.

– 6 November 2007: Germany's Monopolies Commission, a consultative governmental body, says in a study that electricity and gas markets are not functioning open markets. It issues several suggestions: establishing a special regulatory agency dedicated to guarding against gas and electricity market manipulation, avoiding unbundling because it could bring economic risks and legal problems, and forbidding incumbent utilities (E.ON, RWE, Vattenfall and EnBW) to build new power plants, so as to give competitors a chance to build their own generating capacity.

– 6 November 2007: Germany's economy ministry rejects a call from a German consumer group to break up power firms due to alleged power price fixing. Deputy Economy Minister Otremba says new rules enhancing regulatory powers should be given a chance to work first. Otremba says he does not think Rhiel's proposal has much chance of becoming law.

– 7 November 2007: The Federal Grid Agency (President: Matthias Kurth) says the power and gas market still lacks transparency. It observes that customer electricity and gas prices rose despite lower grid charges. Kurth is opposed to a proposal by the Monopolies Commission to impose a moratorium on the big utilities for the construction of power plants. He says there is a need for new capacity in Germany, and that not all plant projects might be completed because of rising building costs.

– 7 November 2007: German Cartel Office says unbundling is the last option, only if everything else fails.

– 14 November 2007: E.ON CEO Bernotat strongly asserts that E.ON has not engaged in anticompetitive practices.

The following main items remain on the agenda.

– Draft legislation on transfer of burden of proof to be passed by the German Parliament: the process should be completed by year-end and the law should come into force in January 2008. Will it prevent any further price increases? We definitely do not think so. What is more likely is that price increases will become more administratively burdensome as they will have to be accompanied by documents justifying that they reflect the fundamentals of the electricity market.

– Potential launch of an antitrust enquiry by the European Commission if the Commission believes it has sufficient proof that E.ON has abused its dominant position. We note that if E.ON is proved guilty (which can only occur in our view if a 'smoking gun' has been found during the European Commission's raids on E.ON's offices), it would be liable to a maximum fine of 10% of global turnover. For E.ON, this would represent circa 7-8% of its share price. We note, however, that it would take at least three years to complete any antitrust proceeding, if one is ever launched. Nevertheless, it is our firm belief that there was no need to cooperate to make past price increases easier to impose. In our view, recent price increases are entirely justified by the rise in the underlying electricity wholesale price, which itself can be explained by the rise in oil and coal prices, the inclusion of the price of CO2 in the price of electricity and decreasing reserve margins.

– Law to be proposed by the State of Hesse on a moratorium on new generating capacity construction: we think that even if this law is passed it would have no real impact on the level of wholesale prices, which do not in our view indicate any abuse of dominant position, but rather high energy commodity prices.

Relying on Russia for growth – a strategic option with limited downside risk

While power generating activities in Russia constitute circa 3% of E.ON's sum-of-parts, we expect the increasing contribution from this division to be the main driver of growth of the group's adjusted EBIT. In a context where the growth of demand for electricity in Germany is flat (it increased by only 1% CAGR between 2002 and 2006 and has been flat in the year to date, once adjusted for the climate), Russian electricity (like the wind development activities) provides the next step for growth.

Albeit starting from a very low level, this division is expected to post 66% CAGR-adjusted EBIT growth between 2008e and 2010e, compared to an average of 10% for group-wide adjusted EBIT.

Table 5: E.ON adjusted EBIT

	2008e adjusted EBIT (EURm)	2008-10e adjusted EBIT CAGR (%)
Central Europe	4,469	14.2
Pan-European Gas	2,319	(1.2)
UK	1,056	4.4
Nordic	788	1.8
US Midwest	401	2.4
Spain/Italy/France	1,003	16.4
Wind	100	40.3
Russia OGK	141	66.3
Group	9,984	10.2

Source: Exane BNP Paribas estimates

We would simply like to point out that liberalisation of the Russian electricity market is unlikely to be a calm riverboat ride, but could somewhat disappoint.

We note that the major plans to invest in new power generators, proposed by the OGKs with the full support of Russian company UES (and hence of the Russian government) and carried out by the acquiring companies like E.ON (OGK4) or ENEL (OGK5), rely on assumptions of 4-5% growth in electricity consumption. They also rely on the assumption that the revenues of power plant operators will be fully liberalised by 2011 and reflect the cost of a new power plant.

This is not an impossible target. However, we note that for OGK4 it would imply average revenue growth per MWh produced of close to 28% per year, with a likely impact at customer level of circa 12-15% per year, which looks optimistic given that:

– the regulation that would guarantee such an increase at a steady pace to 2011 has not yet been passed;

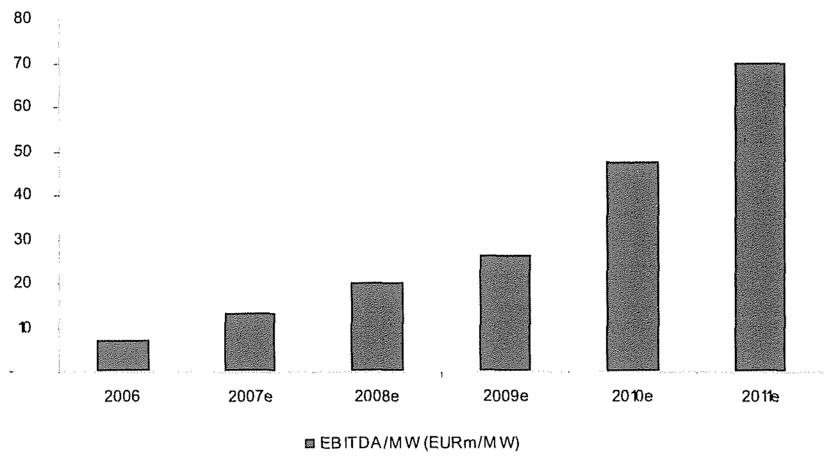
– elections are to be held in 2008 and concerns have already been raised about inflationary pressures on other commodities (food notably). It could be tempting for the Russian government to slow down energy price inflation in Russia.

It thus remains a risk that the pace of price increases (in 2006, OGK4 achieved a price of RUB486/MWh or EUR14/MWh for electricity sold under regulated tariffs – 95% of volumes – and EUR32/MWh at market price), or at least the pace at which customers switch from a low regulated tariff to a higher unregulated tariff, is slower than we would hope. Some could perceive a contradiction with our stance on EDF, where we argue that EDF's regulated tariff is aligned on higher wholesale electricity prices. But there is none: European legislation is already in place (Second Electricity Directive in 2003), and it is only a matter of time before it becomes effective in French law. In Russia, in contrast, there is no supranational body that could exert pressure on the Russian government to respect its commitment to fully liberalise the Russian electricity market.

We note that E.ON's business plan in Russia relies on the business plan presented by UES – assuming that by 2011 electricity prices will reflect the cost of construction of new plants. To quantify the risk E.ON has taken, we compute that any one-year delay in convergence on wholesale prices would cause the enterprise value of E.ON's Russian division to diminish by circa EUR200m, or EUR0.3/share. The risk is thus extremely limited in our view.

Potentially more of a concern but very unlikely in our view would be a decision by the Russian authorities to *indefinitely* postpone deregulation in Russia. We currently estimate that EBITDA per unit of installed electricity generating capacity will rise from EUR7 per kilowatt installed in 2006 to EUR70/kW in 2011, which is consistent with the aggressive pace of convergence by 2011.

Chart 5: Russian power generation activities: EBITDA per unit of generating capacity installed (EUR/kW)



Source: Exane BNP Paribas estimates

If OGK's EBITDA level remains stuck at EUR20/kW forever because of price controls (or overcapacity due to over-optimistic forecasts for electricity demand in Russia), the value of OGK4 to E.ON would be reduced by EUR4.3/s. This is certainly a risk, but a risk that we believe is rather unlikely: we believe that there is a strong political commitment to reforming the electricity market in Russia and we do not expect a major shake-up of the political apparatus, but rather a smooth transition after the Russian elections next year.

Below average exposure to the oil price

Like all utilities exposed to the price of electricity (pure network utilities are the exception), E.ON's share value is dependent on oil prices. Oil prices feed into the price of gas with a 6 to 9 month delay, which in turns feeds into the price of electricity, as it drives the cost of electricity generation in gas fired power plants.

We estimate that a USD10/bl decrease in the price of Brent (assuming constant USD/EUR rate) trims just 3.2% off the valuation of E.ON shares. This compares with an average of 5% for utilities under our coverage active in power generation (the most exposed being RWE, with a 8.2% sensitivity to such a move in the Brent price). In other words, E.ON would be less affected than others by a downturn in oil prices.

Rating definitions

Stock Rating (vs Sector)

Outperform: The stock is expected to outperform the industry large-cap coverage universe over a 12-month investment horizon
Neutral: The stock is expected to perform in line with the industry large-cap coverage universe over a 12-month investment horizon.
Underperform: The stock is expected to underperform the industry large-cap coverage universe over a 12-month investment horizon

Sector Rating (vs Market)

Outperform: The sector is expected to outperform the DJ STOXX50 over a 12-month investment horizon
Neutral: The sector is expected to perform in line with the DJ STOXX50 over a 12-month investment horizon.
Underperform: The sector is expected to underperform the DJ STOXX50 over a 12-month investment horizon

Key Ideas

BUY: The stock is expected to deliver an absolute return in excess of 30% over the next two years Exane BNP Paribas' Key Ideas Buy List comprises selected stocks that meet this criterion

Distribution of Exane BNP Paribas' equity recommendations

As at 10/10/2007 Exane BNP Paribas covered 424 stocks The stocks that, for regulatory reasons, are not accorded a rating by Exane BNP Paribas are excluded from these statistics For regulatory reasons, our ratings of Outperform, Neutral and Underperform correspond respectively to Buy, Hold and Sell; the underlying signification is, however, different as our ratings are relative to the sector.

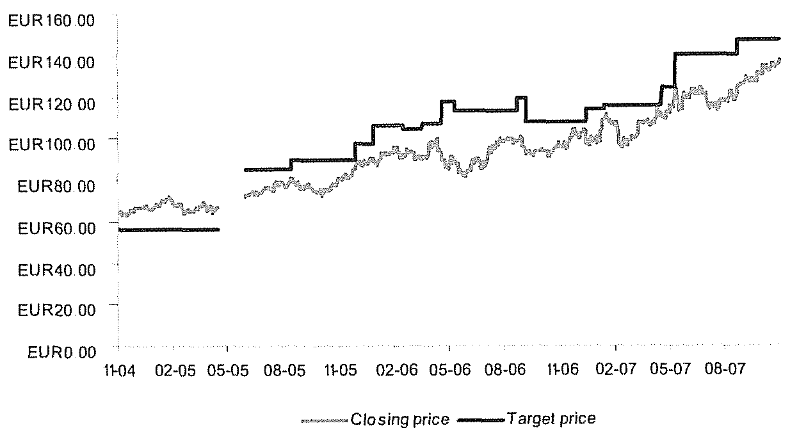
43% of stocks covered by Exane BNP Paribas were rated Outperform. During the last 12 months, Exane acted as distributor for BNP Paribas on the 4% of stocks with this rating for which BNP Paribas acted as manager or co-manager on a public offering. BNP Paribas provided investment banking services to 12% of the companies accorded this rating*.

39% of stocks covered by Exane BNP Paribas were rated Neutral During the last 12 months, Exane acted as distributor for BNP Paribas on the 5% of stocks with this rating for which BNP Paribas acted as manager or co-manager on a public offering BNP Paribas provided investment banking services to 11% of the companies accorded this rating*.

18% of stocks covered by Exane BNP Paribas were rated Underperform. During the last 12 months, Exane acted as distributor for BNP Paribas on the 1% of stocks with this rating for which BNP Paribas acted as manager or co-manager on a public offering. BNP Paribas provided investment banking services to 7% of the companies accorded this rating*

** Exane is independent from BNP Paribas. Nevertheless, in order to maintain absolute transparency, we include in this category transactions carried out by BNP Paribas independently from Exane. For the purpose of clarity, we have excluded fixed income transactions carried out by BNP Paribas.*

E.ON – historical closing price & target price (as of 20/11/2007)



Date	Closing price	Target price	Rating	Changes
12/09/2007	EUR121.18	EUR147 6	Outperform	Target price
01/06/2007	EUR122 18	EUR141	Outperform	Target price
10/05/2007	EUR112.50	EUR125	Outperform	Target price
05/02/2007	EUR109 43	EUR116	Outperform	Target price
05/01/2007	EUR101.69	EUR114	Outperform	Target price
27/09/2006	EUR94 09	EUR108	Outperform	Target price
12/09/2006	EUR98.05	EUR119 6	Outperform	Target price
01/06/2006	EUR90 00	EUR113	Outperform	Target price
11/05/2006	EUR93.41	EUR118	Outperform	Target price
10/04/2006	EUR90.01	EUR107	Outperform	Target price
10/03/2006	EUR90.65	EUR105	Outperform	Target price
19/01/2006	EUR89 55	EUR106.1	Outperform	Target price
21/12/2005	EUR86 45	EUR97 5	Outperform	Target price
06/09/2005	EUR80 61	EUR90	Outperform	Target price
22/06/2005	EUR72.03	EUR85	Outperform	Rating & Target price
10/05/2005	EUR66.50	EUR56.601	Not rated	Rating

Source: Exane BNP Paribas

Commitment of transparency on potential conflicts of interest

Complete disclosures, please see www.exane.com/compliance

Exane

Pursuant to Directive 2003/125/CE and NASD Rule 2711(h)

Questions	Answers
1. Investment banking and/or Distribution	
- Has Exane managed or co-managed in the past 12 months a public offering of securities for the subject company/ies?	**NO**
- Has Exane been acting as distributor for BNP Paribas, when BNP Paribas managed or co-managed in the past 12 months a public offering of securities for the subject company/ies	**NO**
- Has Exane received compensation for investment banking services from the subject company/ies in the past 12 months or expects to receive or intends to seek compensation for investment banking services from the subject company/ies in the next 3 months?	**NO**
2. Liquidity provider agreement and market-making	
- At the date of distribution of this report, does Exane act as a market maker or has Exane signed a liquidity provider agreement with the subject company/ies?	**NO**
3. Corporate links	
- Does the research analyst principally responsible for the preparation of this report or a member of his/her household serve as an officer, director or advisory board member of the subject company/ies.	**NO**
4. Analyst's personal interest	
- Does the research analyst principally responsible for the preparation of this report own a financial interest in the subject company/ies?	**NO**
5. Significant equity stake	
- Does Exane own 1% or more of any class of common equity securities of the subject company/ies as of the end of the month immediately preceding the date of publication of the research report or the end of the second most recent month if the publication date is less than 10 calendar days after the end of the most recent month?	**NO**
- Does Exane own a stable shareholding in the subject company, above the legal threshold defined in article L 233-7 of the French Commercial Code?	**NO**
6. Disclosure to Company	
- Has a copy of this report; with the target price and/or rating removed, been presented to the subject company/ies prior to its distribution, for the sole purpose of verifying the accuracy of factual statements?	**NO**
- Has this report been amended following this disclosure to the company/ies and prior to its distribution?	**NO**
7. Additional material conflicts	
- Is Exane aware of any additional material conflicts of interest with regard to the distribution of the research?	**NO**

Source: Exane

BNP Paribas

Exane is independent of BNP Paribas (BNPP) and the agreement between the two companies is structured to guarantee the independence of Exane's research, published under the brandname « Exane BNP Paribas ». Nevertheless, to respect a principle of transparency, we separately identify potential conflicts of interest with BNPP regarding the company/(ies) covered by this research document.

Potential conflicts of interest: BNP acted as advisor to Endesa against the unsolicited bid of Gas Natural on Endesa (02/2006 to 02/2007)

Source: BNP Paribas

E.ON profile

Business

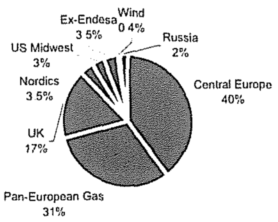
E ON is a leading European electricity and gas utility company It was formed in 2000 from the merger of VEBA and VIAG, and has subsequently disposed of nearly all non-utility businesses to focus on electricity and gas.

In electricity, E ON is one of the four major players in the German market, but also has important assets in the Nordic region, Eastern Europe, the UK and the US.

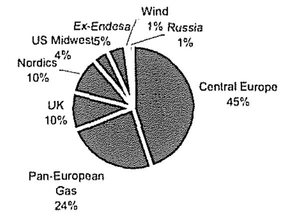
Following the acquisition of Ruhrgas, E ON dominates the German gas market, and has a growing portfolio of international assets, including a stake in the Russian gas producer, Gazprom.

The company has the financial strength to make major strategic moves in electricity and gas, and is likely to invest in upstream gas assets as well as liquefied natural gas (LNG).

2008e Sales by activity



2008e adjusted EBIT by activity



Management

CEO	Wulf Bernotat
CFO	Marcus Schenck
Investor Relations	Kiran Bohjani

Shareholders (%)	Stake
Allianz AG	2.8
Treasury Stock	4.7
Free float	92 5

Sector ratings

	Rating	Price (EUR)	Target price (EUR)	Upside/ (downside) (%)
► Big caps (Priced at 20 November 2007)				
E.ON	(+)	138.2	151.0	9
EDF	(+)	83.8	108.1	29
Enagas	(=)	19.3	18.3	(5)
Endesa	(-)	36.6	36.5	()
Enel	(+)	8.1	9.5	18
Energias de Portugal (EDP)	(+)	4.5	5.6	23
Gas Natural SDG	(-)	43.0	36.3	(16)
Gaz de France	(+)	38.6	46.4	20
Iberdrola	(+)	11.7	11.6	(1)
National Grid	(=)	784.0p	795.0p	1
Red Electrica	(-)	38.9	31.9	(18)
RWE	(-)	91.8	76.8	(16)
Snam Rete Gas	(=)	4.4	4.7	6
Suez	(+)	45.0	50.2	12
Terna	(-)	2.6	2.6	1
Union Fenosa	(+)	47.6	56.6	19
Veolia Environnement	(-)	62.2	59.2	(5)
► Midcaps (Priced at 20 November 2007)				
Séché Environnement	(=)	126.4	130.0	3

Recent Exane publications

Date	Company	Type	Title	Pages
2 Nov. 2007	Enel	Update	Mediterranean diet fattens bottom line	16
2 Nov. 2007	Enel	Update	Q3 to confirm strong momentum for Enel	16
11 Oct. 2007	Utilities	Update	Incentive regulation in France - one significant step ahead	12
21 Sep. 2007	Utilities	Report	Quest for new 'green gold'	44

Diary

Date	Event
6 Mar. 2008	FY 2007 Results
30 Apr. 2008	AGM
14 May 2008	Q1 2008 Results
13 Aug. 2008	H1 2008 Results
12 Nov. 2008	Q3 2008 Results

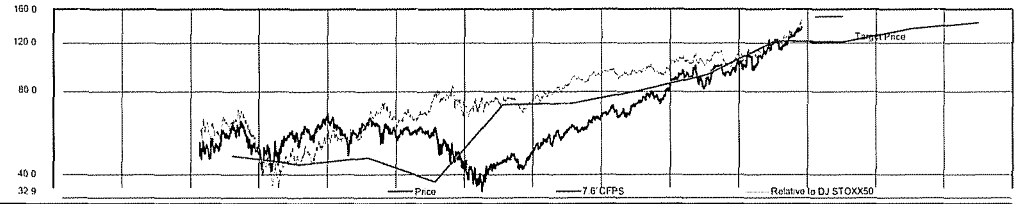
Price at 20/11/07: EUR 138.2 | ***Stock rating vs Sector: Outperform***

Target price: EUR 151.0 / + 9.2% | **Sector rating vs Market: Neutral**

E.ON

Utilities - Germany

Enterprise value (EURm)			98.626
Mkt cap / Free float (EURm)			84.752 / 78 395
3m average volume (EURm)			494 70
12-mth high / low (EUR)			138.2 / 94.5
Performance	**1mth**	**3mths**	**12mths**
Absolute	5%	16%	44%
Rel (Sector)	4%	3%	21%
Rel. (DJ STOXX50)	11%	17%	47%
Reuters/Bloomberg			EONG DE / EOA GY
Analyst: Benjamin Leyre			
CAGR	**2000/2007**		**2007/2010**
EPS restated (*)	33%		11%
CFPS	16%		5%



PER SHARE DATA (EUR)	**Dec. 99**	**Dec. 00**	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06**	**Dec. 07e**	**Dec. 08e**	**Dec. 09e**	**Dec. 10e**
No of shares year end basic (m)	502 798	763 299	659 154	659 154	659 154	659 154	659 154	659 154	613.122	587.196	587.196	587 196
Average no of shares, diluted, excl. treasury stocks (m)	502.798	620.900	715.347	621.582	624.878	626.328	626.328	626.328	619.714	600.159	587.196	587.196
EPS reported	5 95	5.75	3.03	4.26	7 11	6.61	11 24	7 67	11.28	9.91	10.96	11.62
EPS restated	3.10	1 13	3.46	8 97	5 19	6 24	6 01	7 46	8.43	9.29	10.53	11 62
% change	NS	(63.6%)	206 6%	159 0%	(42 1%)	20.1%	(3 6%)	24 1%	13.1%	10.1%	13.4%	10.3%
CFPS	6 13	5 69	6 02	4 93	9.42	9 53	10 62	12 18	16.13	15 99	17.85	18.75
Book value (BVPS) (a)	28 6	36 7	37 1	38 9	45 2	50 9	67 5	72 6	83.3	86.7	92 9	99.2
Net dividend	1.25	1.25	1.35	1.75	2.00	2.35	7.00	3.35	3.85	4.43	5.09	5.35
STOCKMARKET RATIOS	YEARLY AVERAGE PRICES for end Dec. 99 to Dec. 06			*Dec. 02*	*Dec. 03*	*Dec. 04*	*Dec. 05*	*Dec. 06*	**Dec. 07e**	**Dec. 08e**	**Dec. 09e**	**Dec. 10e**
P / E (P/ EPS restated)	17 0x	48 7x	16.7x	5 9x	8 4x	9 3x	12 2x	12 5x	16.4x	14.9x	13.1x	11 9x
P / E relative to DJ STOXX50	81%	241%	70%	26%	53%	67%	92%	112%	150%	145%	139%	
P / CF	8 6x	9 7x	9 6x	10 7x	4 6x	6 1x	6 9x	7 7x	8.6x	8.6x	7.7x	7.4x
FCF yield	2 5%	(0 7%)	0 3%	1 1%	9 1%	8 0%	7 1%	4 9%	5.7%	1.6%	2.1%	2.4%
P / BVPS	1 84x	1 50x	1 56x	1 35x	0 96x	1 14x	1 08x	1 28x	1.66x	1.60x	1.49x	1.39x
Net yield	2.4%	2 3%	2.3%	3 3%	4 6%	4 1%	9 6%	3 6%	2.8%	3.2%	3.7%	3.9%
Payout	40.3%	110.6%	39.0%	19.5%	38.5%	37.7%	116.5%	44.9%	45.7%	47.7%	48.4%	46.0%
EV / Sales	0 57x	0 50x	0 76x	1 55x	0 99x	1 09x	0 91x	0 99x	1.56x	1.56x	1.57x	1.55x
EV / Restated EBITDA	5 5x	5.4x	6 8x	8 0x	4 9x	5 0x	4 9x	5 7x	8.8x	8.5x	7.8x	7.5x
EV / Restated EBIT	12 6x	13 9x	15.3x	13 8x	7 9x	7 3x	7 3x	8 6x	12.0x	11.8x	10.5x	10.0x
EV / OpFCF	15 0x	14 7x	25 6x	13 1x	8 5x	8.8x	8 9x	17 0x	12.4x	19.8x	16.4x	15 6x
EV / Capital employed (incl. gross goodwill)	1.1x	0.8x	1.0x	0.8x	0.7x	0.8x	0.8x	1.1x	1.5x	1.3x	1.3x	1.2x
ENTERPRISE VALUE (EURm)	**27,958**	**36,825**	**52,801**	**55,932**	**42,097**	**48,965**	**47,061**	**63,536**	**98,626**	**105,519**	**112,175**	**113,348**
Market cap	26.491	34 170	41.390	32.772	27.102	36 335	45.809	58 370	84,752	81,168	81,168	81,168
+ Adjusted net debt	1.974	5.546	3.945	16.465	10.992	8.285	(757)	7.212	12,810	23,286	29,943	31,116
+ Other liabilities and commitments	9.934	16.768	16 401	17 155	17 103	17.121	18 821	18 821	18,821	18,821	18,821	18,821
+ Revalued minority interests	2 990	5 123	6.362	6.511	4 625	4.487	4.875	4.917	8,028	8,028	8,028	8,028
- Revalued investments	13,431	24,782	15,297	16,971	17,725	17,263	21,686	25,784	25,784	25,784	25,784	25,784
P & L HIGHLIGHTS (EURm)	**Dec. 99**	**Dec. 00**	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06**	**Dec. 07e**	**Dec. 08e**	**Dec. 09e**	**Dec. 10e**
Sales	**48.963**	**74,048**	**69,839**	**36,126**	**42,541**	**44.745**	**51,854**	**64,197**	**63,107**	**67,597**	**71,466**	**73,184**
Restated EBITDA (b)	**5,112**	**6,882**	**7.820**	**6,965**	**8,550**	**9,823**	**9.519**	**11,150**	**11,234**	**12,373**	**14,381**	**15,148**
Depreciation	(2.895)	(4.242)	(4.363)	(2.909)	(3.230)	(3.159)	(3.068)	(3.751)	(3,034)	(3,429)	(3,694)	(3,806)
Restated EBIT (b) (*)	**2,217**	**2,640**	**3,457**	**4.056**	**5,320**	**6,664**	**6,451**	**7,399**	**8,199**	**8,944**	**10,688**	**11,342**
Reported operating profit (loss)	3.932	7.112	3 683	2.974	5.897	7 232	7.382	4.930	9,470	8,758	10,484	11,120
Net financial income (charges)	(84)	0	5	(2 621)	(1.023)	(1.082)	(607)	(628)	(450)	(1,000)	(1,583)	(1,647)
Affiliates	381	(59)	685	1 334	664	649	433	831	977	1,046	1,074	1,102
Other	0	0	(562)	3.473	697	(9)	3.028	127	0	1	2	3
Tax	(1.051)	(2 512)	(761)	645	(1 124)	(1.947)	(2.276)	323	(2,582)	(2,747)	(3,295)	(3,495)
Minorities	(234)	(469)	(527)	(637)	(464)	(504)	(553)	(526)	(500)	(235)	(247)	(259)
Goodwill amortisation	(276)	(502)	(475)	(2.391)	0	0	0	0	0	0	0	0
Net attributable profit reported	2.668	3 570	2.048	2.777	4.647	4.339	7 407	5.057	6,915	5,823	6,435	6.825
Net attributable profit restated (c)	**1,283**	**200**	**2,003**	**3,185**	**3,245**	**3,906**	**3,763**	**4,672**	**5,227**	**5,574**	**6,185**	**6,825**
CASH FLOW HIGHLIGHTS (EURm)	**Dec. 99**	**Dec. 00**	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06**	**Dec. 07e**	**Dec. 08e**	**Dec. 09e**	**Dec. 10e**
EBITDA (reported)	**6,827**	**11,354**	**8.046**	**5,883**	**9,127**	**10,391**	**10,450**	**8,681**	**12,504**	**12,187**	**14,178**	**14,926**
EBITDA adjustment (b)	**(1,715)**	**(4,472)**	**(226)**	**1,082**	**(577)**	**(568)**	**(931)**	**2,469**	**(1,270)**	**186**	**204**	**222**
Other items	(434)	1 801	(652)	262	266	(761)	(225)	(2 037)	2,455	1,489	1,512	1,420
Change in WCR	(288)	(2,421)	(1,316)	275	(1,191)	(767)	(1,027)	(1,291)	(100)	(265)	(234)	(127)
Operating cash flow	**4.390**	**6,262**	**5,852**	**7,502**	**7,625**	**8,295**	**8,267**	**7,822**	**13,589**	**13,597**	**15,660**	**16,441**
Capex	(2.526)	(3 759)	(3.786)	(3,247)	(2 660)	(2,712)	(2,990)	(4,083)	(5,609)	(8,273)	(8,826)	(9,164)
Operating free cash flow (OpFCF)	**1,864**	**2,503**	**2.066**	**4,255**	**4,965**	**5,583**	**5,277**	**3.739**	**7,980**	**5,324**	**6,834**	**7,277**
Net financial items + tax paid	(1.135)	(2.789)	(1.945)	(3 812)	(2,087)	(2 323)	(1 666)	(628)	(2,738)	(3,862)	(4,993)	(5,141)
Free cash flow	**729**	**(286)**	**121**	**443**	**2,878**	**3,260**	**3,611**	**3.111**	**5,243**	**1,462**	**1,841**	**2,136**
Net financial investments	1.816	(997)	15.972	(9.983)	499	884	5.252	2.876	(6,983)	(11,400)	0	0
Other	0	(662)	(9.981)	(1,446)	3.710	179	2.032	(9.129)	0	0	0	0
Capital increase (decrease)	0	(925)	(3.281)	(11)	7	(18)	(59)	29	(1,500)	(3,500)	0	0
Dividends paid	(646)	(702)	(1.230)	(1.523)	(1 621)	(1.598)	(1.794)	(4.856)	(2,358)	(2,639)	(2,897)	(3,309)
Increase (decrease) in net financial debt	**(1,899)**	**3,572**	**(1,601)**	**12,520**	**(5,473)**	**(2,707)**	**(9,042)**	**7,969**	**5,598**	**16,076**	**1,056**	**1,173**
Cash flow, group share	**3,081**	**3,532**	**4,307**	**3,065**	**5,887**	**5,969**	**6,651**	**7,626**	**9,995**	**9,596**	**10,483**	**11,007**
BALANCE SHEET HIGHLIGHTS (EURm)	**Dec. 99**	**Dec. 00**	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06**	**Dec. 07e**	**Dec. 08e**	**Dec. 09e**	**Dec. 10e**
Fixed operating assets incl gross goodwill	21.945	39.580	46.097	64 178	61 220	61.621	61.110	61.868	71,425	87,669	92,801	98,159
WCR	3.568	8.897	7.529	4.938	967	1.163	(174)	(4.277)	(4,177)	(3,912)	(3,678)	(3,551)
Capital employed, Incl gross goodwill	**25,513**	**48,477**	**53,626**	**69.116**	**62,187**	**62,784**	**60,936**	**57,591**	**67,248**	**83,757**	**89,123**	**94,608**
Shareholders' funds group share	14.382	28.033	24 462	25.653	29 774	33.560	44.484	47.845	51,052	50,886	54,574	58,240
Minorities	2.990	5.123	6.362	6 511	4.625	4.144	4.734	4.917	5,267	5.352	5,449	5,558
Provisions/ Other liabilities	19.868	33.535	32.801	34 309	34.206	34.242	33.862	32 093	32,595	33,108	33,633	35,272
Net financial debt (cash)	1,974	5,546	3,945	16,465	10,992	8,285	(757)	7,212	12,810	28,886	29,943	31,116
FINANCIAL RATIOS (%)	**Dec. 99**	**Dec. 00**	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06**	**Dec. 07e**	**Dec. 08e**	**Dec. 09e**	**Dec. 10e**
Sales (% change)	NS	51 2%	(5 7%)	(48 3%)	17 8%	5.2%	15 9%	23 8%	(1.7%)	7.1%	5.7%	2.4%
Organic sales growth	0 0%	0 0%	0 0%	0 0%	0 0%	0 0%	0 0%	0 0%	0.0%	0.0%	0.0%	0.0%
Restated EBIT (% change) (*)	NS	19 1%	30 9%	17 3%	31 2%	25 3%	(3 2%)	14 7%	10.8%	9.1%	19.5%	6.1%
Restated attributable net profit (% change) (*)	NS	(55.0%)	253.3%	125.0%	(41.8%)	20.4%	(3.6%)	24.1%	11.9%	6.6%	11.0%	10.3%
Personnel costs / Sales	21 2%	14 7%	9 2%	17 9%	11 5%	10 5%	8 8%	-	-	-	-	-
Restated EBITDA margin	10.4%	9 3%	11 2%	19 3%	20 1%	22 0%	18 4%	17 4%	17.8%	18.3%	20.1%	20.7%
Restated EBIT margin	4 5%	3 6%	4.9%	11 2%	12 5%	14 9%	12.4%	11 5%	13.0%	13.2%	15.0%	15.5%
Tax rate	24 9%	35 6%	17 4%	NC	20 3%	28 6%	31 6%	NC	25.8%	31.2%	33.0%	33.0%
Net margin	5.9%	5.5%	3.7%	9.5%	12.0%	10.8%	15.4%	8.7%	11.7%	9.0%	9.3%	9.7%
Capex / Sales	5.2%	5 1%	5.4%	9 0%	6 3%	6 1%	5 8%	6.4%	8.9%	12 2%	12.3%	12.5%
OpFCF / Sales	3 8%	3 4%	3 0%	11 8%	11 7%	12 5%	10.2%	5 8%	12.6%	7.9%	9.6%	9.9%
WCR / Sales	7 3%	12 0%	10 8%	13 7%	2 3%	2 6%	(0 3%)	(6 7%)	(6.6%)	(5.8%)	(5.1%)	(4 9%)
Capital employed (excl. gross goodwill) / Sales	44.8%	51.0%	59.9%	129.9%	103.0%	100.0%	79.4%	59.9%	76.2%	95.6%	97.9%	103.1%
ROE (before goodwill)	10 8%	2 5%	10 1%	21 7%	10 9%	11 6%	8.5%	9 8%	10.2%	11.0%	11.3%	11.7%
Gearing	11%	17%	13%	51%	32%	22%	(2%)	14%	23%	41%	50%	49%
EBITDA / Financial charges	45 2x	134 9x	45 7x	17 6x	7 7x	8 6x	12 9x	16 2x	16.1x	9.9x	7 9x	8 0x
Adjusted financial debt / EBITDA	0.4x	0.8x	0.5x	2.4x	1.3x	0.8x	NC	0.6x	1.1x	1.9x	2.1x	2.1x
ROCE excl gross goodwill	7 6%	5 0%	5 9%	6 1%	8 6%	10 6%	10.7%	13.2%	12.6%	9.5%	10.2%	10 1%
ROCE incl gross goodwill	6 5%	3 9%	4 6%	4 2%	6 1%	7 6%	7 2%	8 8%	9.0%	7.3%	8.0%	8.0%
WACC	6.5%	6.6%	6.9%	6.0%	5.8%	6.2%	5.9%	5.7%	6.0%	6.0%	6.0%	6.0%
Average number of employees	124,188	159,195	169,371	129,905	87,203	68,130	74,829	80,280				

(a) Intangibles: *EUR18,873 00m, or EUR30 per share.* *(b) adjusted for capital gains/losses, impairment charges, exceptional restructuring charges, capitalized R&D, pension charge replaced by service cost*

(c) adj.for capital gains losses, imp.charges, capitalized R&D, exceptional restructuring , (*) also adjusted for goodwill for pre IFRS years

Important notice: Please refer to our complete disclosure notice available on www.exane.com/compliance

This research is produced by EXANE SA and / or EXANE LTD ("EXANE") on behalf of themselves. EXANE SA is regulated by the "Autorité des Marchés Financiers" (AMF) and EXANE LTD is regulated by the "Financial Services Authority" (FSA). In accordance with the requirements of FSA COB 7 16 7R and associated guidances "Exane's policy for managing conflicts of interest in relation to investment research" is published on Exane's web site (www.exane.com). Exane also follows the guidelines described in the code of conduct of the AFEI (Association Francaise des Entreprises d'Investissement) on "managing conflicts of interest in the field of investment research". This code of conduct is available on Exane's web site (www.exane.com)

This research is solely for the private information of the recipients. All information contained in this research report has been compiled from sources believed to be reliable. However, no representation or warranty, express or implied, is made with respect to the completeness or accuracy of its contents, and it is not to be relied upon as such. Opinions contained in this research report represent Exane's current opinions on the date of the report only. Exane is not soliciting an action based upon it, and under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy.

While Exane endeavours to update its research reports from time to time, there may be legal and/or other reasons why Exane cannot do so and, accordingly, Exane disclaims any obligation to do so

This report is provided solely for the information of professional investors who are expected to make their own investment decisions without undue reliance on this report and Exane accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or its contents

This report may not be reproduced, distributed or published by any recipient for any purpose. Any United States person wishing to obtain further information or to effect a transaction in any security discussed in this report should do so only through Exane Inc., which has distributed this report in the United States and, subject to the above, accepts responsibility for its contents.

BNP PARIBAS has acquired an interest in VERNER INVESTISSEMENTS the parent company of EXANE. VERNER INVESTISSEMENTS is controlled by the management of EXANE. BNP PARIBAS's voting rights as a shareholder of VERNER INVESTISSEMENTS will be limited to 40% of overall voting rights of VERNER INVESTISSEMENTS.

PARIS
Exane S.A.
16 Avenue Matignon
75008 Paris
France
Tel: (+33) 1 44 95 40 00
Fax: (+33) 1 44 95 40 01

FRANKFURT
Branch of Exane S.A.
Bockenheimer Landstrasse 23
60325 Frankfurt am Main
Germany
Tel: (+49) 69 42 72 97 300
Fax: (+49) 69 42 72 97 301

GENEVA
Branch of Exane S.A.
Cours de Rive 10
1204 Geneva
Switzerland
Tel: (+41) 22 718 65 65
Fax: (+41) 22 718 65 00

LONDON
Exane Ltd
20 St. James's Street
London SW1A 1ES
UK
Tel: (+44) 20 7039 9400
Fax: (+44) 20 7039 9432 / 9433

MILAN
Branch of Exane S.A.
Via dei Bossi 4
20121 Milan
Italy
Tel: (+39) 02 89631713
Fax: (+39) 02 89631701

NEW YORK
Exane Inc.
640 Fifth Avenue
15th Floor
New York, NY 10019
USA
Tel: (+1) 212 634 4990
Fax: (+1) 212 634 5171

SINGAPORE
Branch of Exane Ltd
20 Collyer Quay
08-01 Tung Center
Singapore 049319
Tel: (+65) 6210 1909
Fax: (+65) 6210 1982

ZURICH
Representative office of Exane S.A.
Lintheschergasse 12
8001 Zurich
Switzerland
Tel: (+41) 1 228 66 00
Fax: (+41) 1 228 66 40

Exane research is also available on the website (www.exanebnpparibas-equities.com) as well as on Bloomberg (EXAA), First Call and Reuters.

E.on (Buy), 6 December 2007

MainFirst Bank AG

Company:	E.on	Rating:	Buy
Price Target:	EUR 159.00	Share Price (Up/Downside):	EUR 143.43 (+10.9%)

Environment remains healthy

CONCLUSION

- **Based on our new forecast of for the reported EBIT of €13.8bn, the E.on mid term target of an €12.4bn EBIT for 2010 looks conservative. The market consensus however still stands even below the conservative E.on target at €11.4bn. Consequently, we expect ongoing increases in the consensus going forward, once the recent acquisitions, as well as the contribution from the growth investments gets reflected in the forecasts.**
- **The stance of German politicians towards the utility sector appears to have eased in the last weeks. The recent amendment of the energy law, as well as the support against the EU initiative on ownership unbundling of grid assets both highlights the improving situation. In this environment the companies should not only be able to implement the announced price increases in 2008, but also benefit from the again higher electricity forward prices for 2009.**
- **Following a string of acquisitions in the current year (Skarv-Idun, Energi E2, Airtricity and OGK4) plus the upcoming closure of the Enel / Endesa transaction, E.on has indicated that it will revert to organic growth. Consequently we see a clearly reduced reinvestment risk in the shares.**
- **E.on shares are still trading on a 13% discount to the peer group based on an average 2007-09 mix of EV/EBITDA and PE valuations. As described in the previous points we see a declining risk profile of the company and therefore expect this gap to close. Based on higher operating results, a lower tax rate and a lower number of shares we increase our estimates by up to 11%. Given that also the valuation of the peer group increased again our price target goes a little more by 12.7% from €141 to €159. We reiterate our Buy recommendation.**

IMPACT

- We have increased our estimates for the adjusted EBIT between 0.6% for 2007 from €9.22bn to €9.28bn and 2.9% from €12.68bn to €13.06bn for 2009. This is based on the announced price increases for end customers in Germany, the healthy electricity price foreseen for the next years and the recently announced acquisitions of OGK4 in Russia. On the other hand we had to adjust for the narrowing of the retail margin in the UK and a slightly weaker contribution from Pan-European Gas in Q4 2007, due to a slightly lower than expected German gas price.

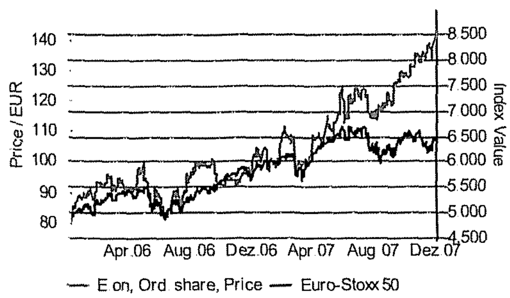
E.on – Key Financials

Year to December	Revenue (€ m)	EBITDA (adj.) (€ m) *	EBIT (adj.) (€ m) *	EPS (adj) (€) *	EV/ Sales	EV/ EBITDA	EV/ EBITA	P/E *	Yield (%)
2005	56,399	9,309	6,451	5.52	1.0	6.0	8.7	13.2	9.6
2006	67,759	10,382	7,452	6.68	1.0	6.5	9.1	14.0	3.6
2007E	66,985	11,278	8,222	8.53	1.6	9.5	13.0	16.8	3.1
2008E	83,472	14,483	10,726	10.57	1.4	8.2	11.1	13.6	3.8
2009E	89,431	16,036	11,962	11.70	1.4	7.8	10.5	12.3	4.2
CAGR 06-09E (%)	*9.7*	*15.6*	*17.1*	*20.5*					

(*) adjusted for exceptional items and acquisition-related amortisation charges — Source: Company accounts, Main*First* estimates

Andreas Thielen
+49-69-78808 217
andreas.thielen@mainfirst.com

Bloomberg / Reuters code	***EOA GY / EONG.DE***
Market cap (Free float)	€90.59bn (92.5%)
DJ EuroStoxx 50	6,505
Next Event	**Q4/FY Results**
Date	**06 March 2008**



DETAILS

- In addition to the good divisional performance, we now also expect a slightly lower tax rate going forward for E.on. In the current year 25% instead of 31% and going forward 29% instead of 30%. Furthermore we have now fully included the effects from the announced €7bn share buyback, which will be carried out until the end of 2008. For the current year, we forecast an average purchase price of €125/share for close to 28m shares, while we assume an average €150/share for 23m shares in 2008.

Table 1: Change in forecasts

	2007 E			2008 E			2009 E		
€m	Old	New	chg.	Old	New	chg.	Old	New	chg.
Sales	66,121	66,985	1.3	80,467	83,472	3.7	86,582	89,431	3.3
EBITDA	12,358	12,339	(0.2)	15,443	15,555	0.7	16,883	17,114	1.4
EBIT	9,222	9,282	0.6	11,603	11,803	1.7	12,686	13,057	2.9
NET rep.	5,898	6,097	3.4	6,336	6,553	3.4	6,795	7,116	4.7
NET adj.	5,108	5,523	8.1	6,336	6,553	3.4	6,795	7,116	4.7
EPS adj. (€)	7.78	8.46	8.8	9.78	10.57	8.1	10.49	11.70	11.5

Source: Main*First* estimates

- The current electricity price environment clearly points to further upside in earnings. Table 2 gives an update on E.on's achieved electricity price in the German market. For the sake of simplicity we focus on the baseload price only. The company has sold nearly 90% of 2008 volumes over the past two years. Given the electricity price development during that period, we calculate that E.on should have achieved an average price of €48.3/MWh. Based on the 2009 forward market price of roughly €58/MWh currently and a forward sales volume of roughly 50%, we see further upside compared to 2008, as we expect E.on to be able to implement further price increases. The mix of already closed forward sales and the open volume translates into an achieved baseload price of €56.3/MWh for E.on in 2009, i.e. still below the current forward market price.

Table 2: Achieved average German electricity price (€ / MWh)

E.on	2005	2006	2007	2008	2009	2010
Forward Base EEX	33.5	37.1	41.8	48.3	56.3	57.3
Forward Peak EEX	49.1	52.7	61.1	67.9	80.3	80.0
Avg price (70% Base/30% Peak)	**38.2**	**41.8**	**47.6**	**54.2**	**63.5**	**64.1**

Source: Company accounts, Main*First* estimates

Notice according to WphG §34b: **Main*First* Bank AG acts as an independent broker.** In preparing and publishing this report no conflicts of interest according to WphG §34b occurred. Neither does Main*First* own a stake in the company analysed nor did it belong to a consortium working for the company in the past 5 years. It also does not act as a designated sponsor for the company.

Disclaimer

This document has been prepared by it(s) author(s) independently of the Company, and none of Main*First* Bank AG, the Company or its shareholders has independently verified any of the information given in this document. The publication has been derived from selected public sources we believe to be reliable and in good faith but neither its fairness, accuracy, completeness or suitability for investors' purposes can be represented or warranted, expressly or impliedly. Opinions expressed herein reflect the current views of the author: they do not necessarily reflect the opinions of Main*First* Bank AG or any of its subsidiaries or affiliates and may change without notice. Neither the author nor Main*First* Bank AG accepts any liability whatsoever for any loss howsoever arising from any use of this publication or its contents or otherwise arising in connection therewith, except as provided for under applicable regulations.

At the date hereof, the author and/or Main*First* Bank AG may be buying, selling, or holding significant long or short positions in securities of the issuer, acting as investment bankers or be represented on the board of the issuer and/or engaging in market making in securities mentioned herein. Accordingly, information may be available to Main*First* Bank AG that is not reflected in this report.

This publication is intended to provide information to assist institutional investors in making their own investment decisions, not to provide investment advice to any specific investor. Therefore, investments discussed and recommendations made herein may not be suitable for all investors: readers must exercise their own independent judgement as to the suitability of such investments and recommendations in the light of their own investment objectives, experience, taxation status and financial position.

Any opinions, forecasts or estimates contained herein constitute a judgement as of the date of this report; there can be no assurance that future results or events will be consistent with any such opinions, forecasts or estimates. This information is subject to change without notice; its accuracy is not guaranteed; it may be incomplete or condensed and it may not contain all material information concerning the Company.

THIS DOCUMENT IS BEING SUPPLIED TO YOU SOLELY IN YOUR CAPACITY AS A PROFESSIONAL INSTITUTIONAL INVESTOR FOR YOUR INFORMATION AND MAY NOT BE REPRODUCED, REDISTRIBUTED OR PASSED ON, DIRECTLY OR INDIRECTLY, TO ANY OTHER PERSON OR PUBLISHED, IN WHOLE OR IN PART, FOR ANY PURPOSE. NEITHER THIS DOCUMENT NOR ANY COPY OF IT MAY BE TAKEN OR TRANSMITTED INTO THE UNITED STATES, CANADA OR JAPAN OR DISTRIBUTED, DIRECTLY OR INDIRECTLY, IN THE UNITED STATES OR CANADA, OR DISTRIBUTED OR REDISTRIBUTED IN JAPAN OR TO ANY RESIDENT THEREOF. THE DISTRIBUTION OF THIS DOCUMENT IN OTHER JURISDICTIONS MAY BE RESTRICTED BY LAW, AND PERSONS INTO WHOSE POSSESSION THIS DOCUMENT COMES SHOULD INFORM THEMSELVES ABOUT, AND OBSERVE, ANY SUCH RESTRICTIONS. BY ACCEPTING THIS REPORT YOU AGREE TO BE BOUND BY THE FOREGOING INSTRUCTIONS.

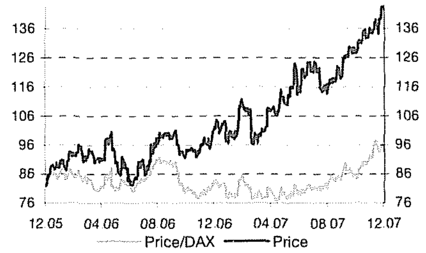
Germany

NEWS

UTILITIES

Rating	From 2 to 3
Target price (6 months)	+2% EUR146.00
Price (10/12/07)	EUR142.70
Market capitalisation	EUR90.129bn

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)	14.8	15.6	14.3
EV/EBITDA (x)	8.9	8.5	8.0
EV/EBITA (x)	11.9	11.3	10.7
FCF yield (%)	2.7	-7.6	-0.3
ROE (%)	13.9	12.0	12.0
Net yield (%)	2.7	3.2	3.5

Sector focus

Sector Top Picks	Enagas, Suez
Least favoured	SNAM Rete Gas

E.ON

Downgrade to 3/Underperform

- *Downgrade to 3/Underperform due to lack of upside*
- *Possible legal risk from revised Competition Law*
- *Target price raised from EUR137 to EUR146*

Downgrade to 3/Underperform...

We downgrade E.ON to 3/Underperform due to lack of upside. Since reiterating our 2/Outperform recommendation on 10 May 2007, the stock has soared some 29% vs. the DAX's ~8% increase. If market remains difficult in 2008, we do however believe the stock will continue to serve as a safe haven, driven by its moderate gearing, low beta and attractive dividend yield.

...supported by possible legal risk

On the risk side, E.ON and German utilities in general could increasingly come under pressure following the announced increase in household electricity prices by between 6-10% from January 2008 and the reply of the Federal Cartel Office (FCO) to thoroughly study those increases given its new power from the revised Competition Law. Though we don't expect the FCO to block the price rises, the legal risk and the uncertainty, plus a possible earnings delay clearly do not favour the utilities' environment.

Target price raised

Finally, we have raised our price target from EUR137 to EUR146 to incorporate a long-term electricity price scenario of EUR55 per MWh (vs. EUR48 previously) due to a) the increase in Cheuvreux long-term oil price forecast from USD50/bbl to USD60/bbl from 2010 and onwards and b) the rise of construction costs for power plants. With regards to CO2 allocation, we assume a step-wise decrease in the % of free CO2 certificates between 2013-2020.

If we were to assume EUR60 per MWh from 2010, our fair value would increase to c.EUR152 (EUR1 per MWh leads to EUR1.30 price target). If we, additionally, assume no free allocations from 2013, this would decrease our FV to EUR146. Our EPS ests. are unch'd, as we only changed our assumptions for 2010 and beyond.

Sebastian Kauffmann
Investment Analyst
(49) 69 478 97 524
skauffmann@cheuvreux.com

BEST REGARDS,
CHEUVREUX

Equity Research

WestLB

10 December 2007

E.ON & RWE St.

Time to spot on 2008 and beyond: Good times for RWE and E.ON

We believe RWE and E.ON have good chances to outperform the European utilities sector next year. It seems like déjà vu: the electricity price story should continue to boost earnings growth. We believe that the market is still pricing in wholesales prices of €55 per MWh into the SoP models for both companies. Current market prices are closer to €60 and we do not believe in the story that coal and crude oil prices will come down markedly next year. On top of this, we believe that RWE and E.ON can raise some value by investing in renewables. Here, investors still do not have a clear view about which renewables can deliver to both generation portfolios. The debate about the revival of nuclear power generation in Europe, and the view that Germany will not be able to reach its environmental targets for 2020 without a prolongation of lifespan of nuclear power, could be triggers to incorporate some of the upside here. As the mentioned stories are mainly coupled with the fair valuation of RWE's and E.ON's domestic electricity generation portfolios, we believe that RWE will be more of a beneficiary. With a 12-month horizon, we have upgraded RWE to Buy with a new target price of €112. The effect of the disappointing news from postponing the AWW IPO should be behind us. For E.ON, we are sticking to our Add recommendation and a new target price of €158.

E.ON: Forecasts and multiples

Year End Dec	Sales (€m)	EBITDA (€m)	EPS (€)	P/E (x)	EV/EBITDA (x)	Yield (%)
2006 A	64,197	11,353	7 10	20 2	9 3	2 3
2007 E	68,835	12,551	8 45	17 0	9 3	2 9
2008 E	80,894	15,032	9 68	14 8	8 8	3 5
2009 E	87,823	15,886	10 49	13 7	8 5	3 8

Source E ON, WestLB Research Estimates

RWE St.: Forecasts and multiples

Year End Dec	Sales (€m)	EBITDA (€m)	EPS (€)	P/E (x)	EV/EBITDA (x)	Yield (%)
2006 A	44,256	7,861	4 38	21 9	10 2	3 6
2007 E	44,309	8,865	5 27	18 2	9 0	3 1
2008 E	48,321	9,770	7 22	13 3	8 1	5 2
2009 E	50,205	9,885	7 79	12 3	7 6	4 4

Source RWE. WestLB Research Estimates

E.ON

Add	€143 4
(Remains Unchanged)	
Target Price:	€158
	(€147)
RIC:	EONG F
Bloomberg Ticker:	EOA GR
Market Cap :	€90,813m
EPS	
Dec 2006 A	€7 10
Dec 2007 E	€8 45
Dec 2008 E	€9 68
Dec 2009 E	€10 49
WestLB Research Estimates	

Current recommendation since 23/03/2007
Previous recommendation was Hold

RWE St.

Buy	€96 2
(Hold)	
Target Price:	€112
	(€96)
RIC:	RWEG DE
Bloomberg Ticker:	RWE GR
Market Cap :	€53.570m
EPS	
Dec 2006 A	€4 38
Dec 2007 E	€5 27
Dec 2008 E	€7 22
Dec 2009 E	€7 79
WestLB Research Estimates	

Research Analysts
Peter Wirtz +49 (0)211 826 3579
peter wirtz@westlb de
Sebastian Zank +49 211 826 74604
sebastian zank@westlb de

Disclosures and statements required by regulatory bodies are shown on the last page

Sales
Düsseldorf: +49 211 826 4848
London: +44 20 7020 4316
New York: +1 212 4033900

- **Electricity price story remains a major driver.** Electricity wholesale base load prices in Central Europe have risen to record levels slightly above €60 per MWh. With persistently high international hard coal prices and high crude oil prices, it looks to us ever more likely that our assumptions that RWE and E.ON will be able to lock in base load prices of €54 per MWh on average in the period 2008-2012 could prove to be too pessimistic. Above all, the risk of the German cartel authorities biting into the German generators' margins with the new legal framework has diminished with the latest changes in the law. We have raised our assumptions for the German generation portfolios owned by RWE and E.ON in central Europe; we lock in average base load prices of €58 per MWh.

- **Additional value via investment into renewables and presentations of strategy.** With its planned strategic presentation in February next year, RWE will get a chance to explain its potential growth path based on an existing renewable portfolio including hydropower, which is worth €3.5bn according to our assumptions. Moreover, E.ON has set the nucleus with the acquired wind portfolios in the US and the Iberian peninsula to boost its international growth. Including hydropower, E.ON's portfolio should be worth close to €8bn.

- **Revival of nuclear power in Europe should give some upside to the valuations for RWE and E.ON.** First and foremost, the UK is closer to reaching a government decision on nuclear and about licensing a new project. In addition, the tougher EU target of cutting emissions in the period leading up to 2020 could heat up the debate in Germany over the course of 2008 as to whether these goals could be only achieved with extended lifespans for nuclear power stations. As the next elections will be in 2009, investors who expect the conservatives and liberals to win these elections will tend to incorporate some of the upside into the models of RWE and E.ON - we have done this now.

- **RWE with upgrade to Buy and price target of €112.** Following the disappointment after the postponement of the American Water Works IPO, we believe investors should increasingly concentrate on RWE's sound fundamentals again. With its current portfolio, RWE can deliver a CAGR of slightly above 10% in the period 2006-2010. Moreover, the communication of RWE's strategic path for the future in February 2008 could deliver some positive sentiment support. What explains the difference compared to our old price target of €96? RWE Power's valuation is up €8 per share with raised assumption in terms of realised generation prices and a different modelling for the valuation of RWE's nuclear power stations. The remainder results from scrolling our SoP model to 2009 estimates and updating some debt and provision figures. The horizon for the new price target is scrolled and now incorporates a 12M-view. We expect a €3 dividend for 2007 to be paid in April; adding this to our new target price would give almost 20% upside.

- **E.ON with Add and a new price target of €158.** E.ON has guided to deliver CAGR for operating earnings of 10% up to 2010. With higher electricity generation prices we believe it is most likely that E.ON will overshoot this goal. Our updated model gives an annual growth path of 12%. Also here we have scrolled our SoP model to 2009 estimates. Main reasons for upgrading the price target from €147: Higher valuation of E.ON's generation fleet. In addition, heavy investment in broadening E.ON's pan-European gas business means additional value for this unit.

RWE with good chances of a strong performance next year

We have incorporated higher average realised prices for the next years to come. Here we incorporate higher fuel costs, which should translate into higher average realised prices for the RWE generation portfolio. Following the release of the draft law to empower the German Federal Cartel Authorities to check the pricing of the German generators, we have become more relaxed. This new law will limit the risk of the cartel authorities biting into the generation margin of Germany's generators. All in all, RWE has a chance to raise its prices further beyond 2008 as well. Our old model included the assumption that prices would probably flatten out from 2008 onwards for a while.

Our earnings model for RWE is based on the assumption that RWE can lift the average realised generation price from €38 per MWh in 2006 to €58 per MWh by 2010. In the period between 2008 and 2013, we have assumed that the electricity forward prices will flatten out for a while. Main reason here is that coal forward prices are on the way down. Current forwards (Richard's bay - South Africa) for 2010 are more than 10% below the forwards for 2008. In addition, also huge bulk fright rates are expected to drop markedly from currently very high levels with new carriers coming on stream over the next years.

Germany: Base load power prices and RWE's realised electricity prices

€ per MWh	2006	2007e	2008e	2009e	2010e	2011e	2012e	2013e
Germany: Base load power prices	44.0	53.0	59.9	60.4	58.2	58.3	59.5	61.0
RWE: Average realised price	38.0	46.0	53.0	57.0	58.0	58.0	59.0	61.0

Source WestLB Research estimates

Our earnings estimates for RWE are relative close to the consensus expectation (acc to JCF) with the exception for 2008. Here the reason is probably that we have still incorporated the earnings contribution from American Water Works for 2008. RWE still stick to its plans to sell these assets via an IPO in 2008. Following the misleading guidance that the AWW could have been finalised by the end of the year, RWE is now very reluctant about setting an aggressive schedule for this deal. All in all, with our model update we have become more optimistic regarding RWE'S operating earnings trend beyond 2009.

RWE: EBITDA forecasts 2007e-2010e

€m	2006	2007e	2008e	2009e	2010e
RWE Group (JCF-estimates)	7,861	8,654	9,103	9,717	na
RWE Group	7,861	8,865	9,770	9,885	10,524
RWE Power	3,372	4,482	5,248	5,934	6,220
RWE Energy	3,177	2,961	3,124	3,219	3,514
RWE nPower	658	883	838	881	940
RWE Water	689	690	711	0	0
Consolidation	-35	-150	-150	-150	-150

Source JCF. WestLB Research estimates

Our SoP model is earmarked to explain the upgrade in RWE valuation. Clearly the electricity generation portfolio in Germany remains a major driver. We would like to add that we have decided to incorporate some of the upside valuation for a prolongation of nuclear power station lifespans in Germany into our model. Here, our assumption is that the discussion relating to the reduction of emissions in Europe will gain pace. With the latest standstills of RWE's Biblis power stations, it has become obvious that a decision about a phase has to be postponed until the next election period in 2009. We now have incorporated as base case that the German generators will be allowed to lift the lifespan by 20 years to 52 years for modern plants. This means that RWE would have to shut down its two oldest nuclear power stations after 32 years of run-time. As this is far from being clear yet, all is incorporated with a 50% likelihood.

RWE: Sum of the parts-Valuation (new 2009e; Old: 2008e)

				NEW	OLD
Business unit	Valuation metrics	EBITDA-Multiple (x)	€m	€/Share	€/Share
RWE Power		6,3	34.903	62,06	55,21
Electricity generation Germany	DCFs	6,0	27 788	49,41	42,92
- Nuclear energy	DCFs	-	6 085	10,82	11,66
- Nuclear power - prolonged lifespan	+20Y for 2/3 of fleet with 50% likelyhood		2 453	4,36	0,00
- Coal and lignite power stations	DCFs	-	12 002	21,34	21,00
- Gas & Oil power stations	DCFs	-	1 424	2,53	2,53
- Hydro & Renewable energies	DCFs	-	3 324	5,91	5,06
- Power stations under construction	Capex	-	2 500	4,45	2,67
Electricity generation international	DCFs	-	852	1,51	1,05
RWE Trading	EBITDA (x)	4,3	750	1,33	1,33
RWE DEA	EBITDA (x)	7,0	5 514	9,80	9,91
RWE Energy		8,7	27.580	49,04	47,40
German regions	EBITDA (x)	8,7	14 071	25,02	25,53
International regions	EBITDA (x)	8,8	6 646	11,82	10,49
High-voltage grid & Gas midstream	EBITDA (x)	8,3	6 863	12,20	11,38
RWE nPower	EBITDA (x)	9,0	7.757	13,79	13,32
Financial investments & Corporate center	Book value & EBITDA (x)	-	8.275	14,71	15,00
Enterprise Value		7,7	78.515	139,61	130,93
plus assets up for sale (AWW)			6 200	11,02	11,02
minus net debt (adjusted)			-2 732	-4,86	-5,71
minus long-term provisions			-17 195	-30,57	-33,75
minus minority interests			-2.850	-5,07	-6,67
SoP-Value Total			61.938	110,13	95,82

Source WestLB Research Estimates

E.ON in delivery mode

E.ON is on track to overshoot its EBIT goal for 2010 which is €12.4bn. We expect the E.ON group to deliver an EBIT of close to €13bn. All in all, we seem to be a bit more optimistic about E.ON's earnings trend compared to the consensus (acc to JCF). Here, we would like to add that there is still upside and downside within E.ON's single divisions. E.g. E.ON hopes to generate an EBIT of close to €1bn in Russia by early in the next decade. We have only incorporated €250m to be generated by 2010, which is markedly below E.ON's assumptions. On the contrary, it is still not clear what impact the German regulator's (Bundesnetzagentur) introduction of an incentive mechanism to cut gas transmission fees from January 2009 onwards will have. Here, E.ON Ruhrgas, with a market share of about 55% in this business, is the company which is coupled most with this story.

E.ON: EBIT forecasts 2007e-2010e

€m	2006	2007e	2008e	2009e	2010e
E.ON Group (JCF-estimates)	8,150	8,905	10,241	11,322	na
E.ON Group	8,150	9,322	11,203	11,882	12,921
Central Europe	4,168	4,792	5,184	5,796	6,333
Gas Europe	2,106	2,681	2,771	2,660	2,849
Nordic	619	807	807	799	854
UK	1,229	1,024	1,127	1,185	1,237
US Midwest	391	395	385	380	371
New markets	53	0	1,325	1,474	1,708
Other/Corporate	-416	-377	-394	-413	-432

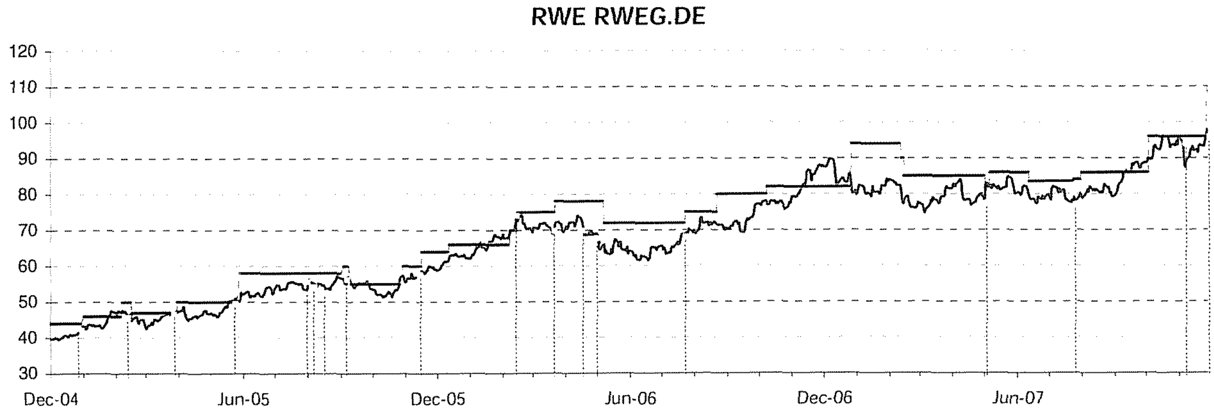
Source JCF, WestLB Research estimates

Our updated SoP model gives a fair value of €158 for E.ON. This is our new price target with a 12-month view. Above all, E.ON's German generation portfolio registers a higher valuation with the updated price model and by incorporating some value for the prolongation of lifespan of E.ON's nuclear power stations in Germany. Furthermore, we have subtracted the two oldest power stations (Kruemmel and Brunsbuettel) from the list after a lifespan of 32 years. The remainder is now incorporated for the first time with a 50% likelihood. In addition, we have separated E.ON's renewables activities with the newly acquired windpower portfolios in the US and Iberia as well as the activities in UK into the segment "Other" within the business unit Central Europe.

E.ON: Sum of the parts-Valuation (new 2009e, Old: 2008e)

				NEW	OLD
Business unit	**Valuation metrics**	**EBITDA-Multiple (x)**	**€m**	**€/Share**	**€/Share**
Central Europe	DCFs & EBITDA (x)	8,5	63.262	101,7	85,8
Central Europe West Electricity	DCFs & EBITDA (x)	8,5	49 142	79,0	71,7
Central Europe West Gas	EBITDA multiple (x)	8,7	4 322	6,9	6,0
Central Europe East	EBITDA multiple (x)	8,0	5 114	8,2	7,3
Other (mainly renewables)	EBITDA multiple (x)	8,0	4 685	7,5	0,8
Pan-European Gas	DCFs & EBITDA (x)	9,0	29.953	48,1	42,0
Nordic	EBITDA multiple (x)	9,0	10.374	16,7	16,8
UK	EBITDA multiple (x)	8,8	14.600	23,5	25,7
US-Midwest	EBITDA multiple (x)	9,0	4.792	7,7	7,6
New Markets	EBITDA multiple (x)	8,5	17.309	27,8	25,5
Endesa/Viesgo	EBITDA multiple (x)	7,3	13 309	21,4	19,9
Russia (OGK-4)	Purchase price	-	4 000	6,4	5,6
Other Minority Interests/Corporate Center			17.372	27,9	33,1
Long-term Securities	Fair values (€)		8 000	12,9	12,7
Other Investments	Book values, market values (€)		13 030	20,9	25,9
Adjustment Corporate Center	*EBITDA multiple (x)*	8,0	-3.658	-5,9	-5,5
Enterprise Value			157 663	253,4	236,5
minus net debt (adjusted)			-22 318	-35,9	-34,9
minus minority interests			-11 697	-18,8	-14,3
minus long-term provisions			-25.430	-40,9	-40,6
SoP-Value Total			98.218	157,9	146,7

Source WestLB Research Estimates



Date	Price	Changed to...	Date	Price	Changed to...	Date	Price	Changed to...
06-Dec-07	97 59	Buy	27-Apr-06	68 81	Add	17-Aug-05	54 35	Hold
14-Nov-07	88 68	Hold	31-Mar-06	71 82	Buy	11-Aug-05	55 31	Add
02-Aug-07	78 91	Add	23-Feb-06	72 60	Hold	06-Jun-05	50 55	Buy
11-May-07	82 70	Hold	25-Nov-05	58 60	Add	08-Apr-05	47 30	Add
01-Aug-06	68 04	Add	19-Sep-05	55 24	Hold	24-Feb-05	45 03	Hold
11-May-06	66 83	Hold	29-Aug-05	53 74	Add	10-Jan-05	43 30	Add

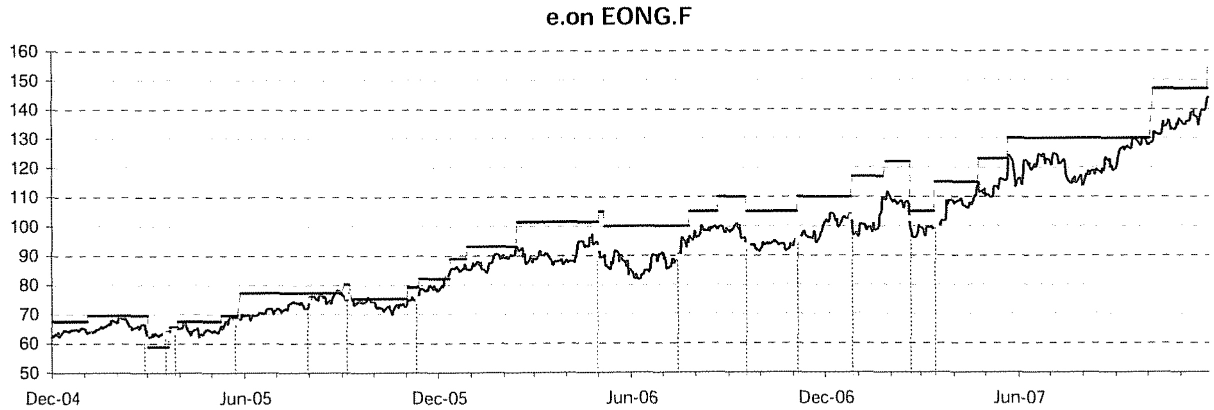
Source FactSet/JCF. WestLB Research

Coverage History Rating at 10/12/2004 was Hold

Disclosures valid as the month prior to publication of this report*:

- WestLB makes a market in bonds issued by RWE.
- WestLB during the last twelve months has provided or agreed to provide investment banking services for which it has received or will receive compensation to RWE.
- RWE may during the last twelve months have been a client of WestLB. During this period WestLB may have provided this company/these companies with non-investment banking securities related services and/or non-securities services for which WestLB may have received compensation.

* Updating this information may take up to ten days after month end.



Date	Price	Changed to...	Date	Price	Changed to...	Date	Price	Changed to...
23-Mar-07	100 69	Add	25-Jul-06	89 93	Add	06-Jun-05	68 47	Buy
28-Feb-07	99 14	Hold	11-May-06	91 79	Hold	08-Apr-05	65 23	Add
04-Jan-07	101 69	Buy	22-Nov-05	77 89	Add	31-Mar-05	63 98	Hold
14-Nov-06	95 74	Add	19-Sep-05	75 06	Hold	11-Mar-05	62 34	Reduce
27-Sep-06	92 96	Hold	11-Aug-05	75 15	Add			

WestLB

WestLB AG
Herzogstrasse 15
D-40217 Dusseldorf
Germany

T: +49 (0)211 826 71841
F: +49 (0)211 826 6154

WestLB AG
London Branch
Woolgate Exchange
25 Basinghall Street
London EC2V 5HA
United Kingdom
T: +44 (0)20 7020 2000
F: +44 (0)20 7020 4209

Regulator: WestLB AG is authorised and regulated by the Bundesanstalt fur Finanzdienstleistungsaufsicht and by the Financial Services Authority. It is regulated by the Financial Services Authority for the conduct of UK business.

Disclosures of potential conflicts of interest relating to WestLB AG, its affiliates and subsidiaries (together "WestLB") as required by regulatory authorities can be accessed at http://www.westlb.de/disclosures_eq_en or obtained by writing to the Compliance Department at one of the addresses above.

WestLB Equity Research: Distribution of ratings as of 05 September 2007

Coverage universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy/Add	180	66	Buy/Add	51	77
Hold	67	25	Hold	13	20
Sell/Reduce	24	9	Sell/Reduce	2	3

* Companies from which WestLB AG or an affiliate or subsidiary has received compensation for investment banking services within the past 12 months

This research report was prepared by WestLB AG, an affiliate of WestLB Securities Inc. ("WSI") or other person that may not be registered as a broker-dealer in the United States. The company that prepared this report may not be subject to US rules regarding the preparation of research reports and the independence of research analysts.

RIDER

WSI accepts responsibility for the contents of this research report to the extent that it is delivered to a person that is not a "major U.S. Institutional Investor" or a "U.S. Institutional Investor" as those terms are defined in Rule 15a-6 under the U.S. Securities Exchange Act of 1934, as amended, or to any person resident in the state of California, Colorado, Louisiana, New Mexico, Ohio, Tennessee or Vermont.

Any US person who desires to effect transactions in any security in this report should write or call WSI, 1211 Avenue of the Americas, New York, NY 10036, phone (212) 403 3939.

The relevant research analyst(s), as named on the front cover of this report, certify that (a) all of the views expressed in this research report accurately reflect their personal views about the securities and companies mentioned in this report; and (b) no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views expressed by them in this report.

The remuneration of WestLB Research Analysts is not related to specific investment banking transactions. It is in part linked to the overall profit made by the firm, which includes the profit of the Investment Banking Department.

WestLB's investment recommendations are kept under continuous review. It follows that no date can be given for the next update of the conclusions of this report.

Conflicts of interest

WestLB's Policy on Management of Conflicts of Interest in Research (the Research Policy) is available at http://www westlb de/research_policy_en This report complies with the Research policy

Valuation and Risk assessment; Recommendations

Unless otherwise stated in the text of this report. target prices in this report are based on either a discounted cash flow valuation or comparison of valuation ratios with companies seen by the analyst as comparable or a combination of the two methods. The result of this fundamental valuation is adjusted to reflect the analyst's views on the likely course of investor sentiment

Whichever valuation method is used there is a significant risk that the target price will not be achieved within the expected timeframe Risk factors include unforeseen changes in competitive pressures or in the level of demand for the company's products Such demand variations may result from changes in technology. in the overall level of economic activity or in some cases. in fashion Valuations may also be affected by changes in taxation. in exchange rates and. in certain industries. in regulations Investment in overseas markets and instruments such as ADRs can result in increased risk from factors such as exchange rates exchange controls taxation political and social conditions This discussion of valuation methods and risk factors is not comprehensive – further information is available if required

Stock ratings are based on the analyst's expectation of the stock's total return during the twelve months following assignment of the rating This view is based on the target price. set as described above. and on the analyst s opinions on general market and economic developments

Within that overall framework. a Buy rating means that the total return from the stock is expected to exceed 20%; Add means between 10% and 20% Hold means movement between 0% and a positive 10% Reduce means between 0% and minus 10%; Sell means the stock is expected to return less than minus 10%

Distribution and Use of Report

This research report has been prepared by a research department of WestLB AG Communication in the United Kingdom is by WestLB AG London Branch In the United Kingdom this report is available only to investment professionals. not private customers. as defined by the rules of the Financial Services Authority Individuals who do not have professional experience in matters relating to investments should not rely on it

This report is for information purposes only The information contained herein has been obtained from sources believed by WestLB AG to be reliable however no guarantees, representations or warranties are made as to its accuracy. completeness or suitability for any purpose Any opinion or estimate expressed in this report reflects the judgement of the author or authors on the date of this report and is subject to change without notice The past performance of securities or financial instruments is not indicative of future results. No assurance can be given that any portfolio or investment described herein would yield favourable investment results This material is not intended as an offer or solicitation for the purchase or sale of any security. financial instrument or any other action and will not form the basis or a part of any contract

Further information may be obtained from your usual contact within West LB AG. No part of this publication may be copied or redistributed to persons or firms other than the authorised recipient without the prior written consent of WestLB AG The manner of distributing this document may be restricted by law or regulation in certain countries. including the United States Persons into whose possession this document may come are required to inform themselves of and to observe such restrictions

WestLB AG London Branch is a member of the London Stock Exchange and of the International Capital Market Association

Dresdner Kleinwort

Top picks for 2008

13 December 2007

Utilities sector outlook 2008

Going for nine in a row

At a P/E relative of 129, a 2009 P/E of 15.1x and a 2009 EV/EBITDA of 8.5x the European utility sector is not cheap. However, in a challenging macro environment we believe that the sector offers predictable earnings growth over the next two years, potential power price spikes above new entry level and possible M&A activity. We expect the sector to post yet another year of outperformance.

- **Recession-proof earnings?** Regulated utilities should see hardly any impact on their earnings streams even under recession scenarios. Even competitive utilities are unlikely to see earnings downgrades as average achieved power prices still have a long way to go before they catch up with current market prices.
- **Phase II CO_2 at €25/t:** We now forecast a deficit of 1,436 $MtCO_2$ over Phase II (2008-2012), which in our view is unlikely to be met by industrial response and CDM/JI supply. Updating our estimates for the finalised National Allocation Plans, we estimate that 136 $MtCO_2$ of fuel switching abatement will be needed from the generation sector. On our commodity assumptions this translates to an average clearing price of €25.0/tonne over Phase II (upgraded from €19.5/MWh that we were forecasting in February this year).
- **Coal, oil and capital costs:** We see no near-term reason for the current high freight rates, which have been driving coal prices up, to decline. This bodes well for near-term power prices. Interestingly, the correlation of the sector's performance to the oil price has become even more pronounced over 2007 (a R^2 of 93%).
- **New entry cost at €62/MWh:** Tempting as it is to use the oil forward curve for commodity price inputs in new entry calculations, we doubt that many utilities make their CCGT new-build decisions on long-term oil prices of $80/bbl or more. Allowing for the increase in capital cost, higher CO_2 prices and long-term oil prices of $70/bbl real ($77/bbl nominal by 2012) we see new entry prices at €62/MWh real (€65/MWh nominal by 2012).
- **From growth to re-rating:** The past eight years have seen a steady re-rating of regulated earnings streams. With average achieved power prices of €35-45/MWh having a lot of catching-up to do with current market prices, the generators' earnings could see a similar re-rating in an uncertain macro-environment.
- **M&A:** GDF-Suez, Suez Environmental's IPO and E.ON's acquisition of Endesa Europe/Viesgo should close in 2008. In addition to that, the Spanish general election in March could bring about more corporate activity, as could Italian municipal consolidation and the seemingly unrelenting appetite for UK infrastructure assets.
- ***All set for another year of outperformance:*** The above factors all point to another year of outperformance for the European utility sector, in our view. As a result we upgrade our sector stance to Overweight from Neutral.
- **Top picks:** We see the highest potential total returns in selected power price plays **RWE, EDF, E.ON** as well as **Enel** and **Enagas**.

Research Analysts

Lueder Schumacher
+44 (0)20 7475 2491
lueder schumacher@dkib com

Geraint Anderson
+44 (0)20 7475 2535
geraint anderson@dkib com

Javier Suarez
+39 02 72 402 344
javier suarez@dkib com

Ajay Patel, CFA
+44 (0)20 7475 1889
ajay patel@dkib com

Scott Phillips
+44 (0)20 7475 4967
scott phillips@dkib com

Luigi Monica
+39 02 7240 2583
luigi monica@dkib com

Meriem Kettani Salam
+44 (0)20 7475 2352
meriem kettanisalam@dkib com

Contents

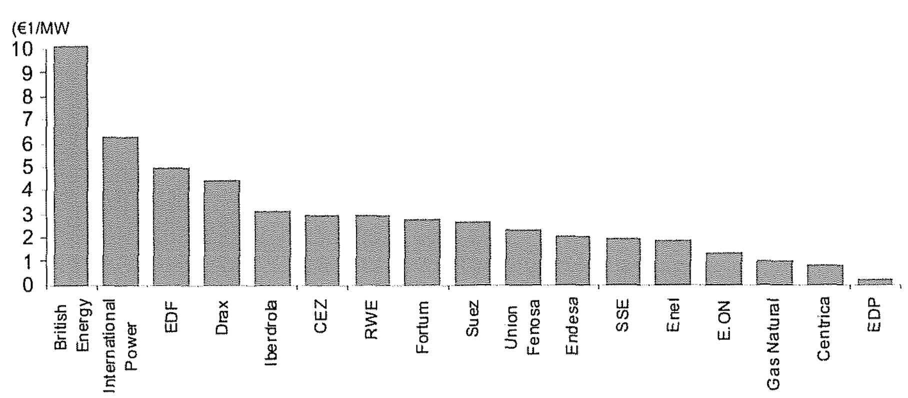
Investment summary	**3**
Which way for power prices?	**5**
Coal prices soar	5
Why have coal prices risen?	6
CO_2 update	**13**
Swings and roundabouts	13
Supplementary limits	16
What are the CO_2 abatement options for Phase II?	17
Phase III -- a big driver for Phase II?	18
Conclusion	20
Capital costs on the rise	**21**
Eight years of outperformance	**26**
Oil prices	28
2008 – more of the same, but in a more difficult environment	**30**
M&A	31
It's all relative... Upgrade to Overweight from Neutral	**33**
Most attractive for 2008	35
Company section	**37**

Investment summary

Raising our Phase II CO_2 price forecasts from €19.5 to €25/tonne and raising our oil price and capital cost assumptions increase our new entrant price to €62/MWh real. In our view, the utilities' predictable near-term earnings growth is likely to remain attractive – especially if the macro conditions in 2008 deteriorate. Potential M&A activity adds further to the sector's attractiveness. We raise our sector stance from Neutral to Overweight with RWE, EDF and E.ON our preferred power price plays (while Enel and Enagas also offer potential upside).

- **We raise our Phase II CO_2 price assumption.** For Phase II we forecast a deficit of 1,436 $MtCO_2$ over 2008-2012, which in our view is unlikely to be met by industrial response and CDM/JI supply. On our commodity assumptions this translates to an average clearing price of €25.0/tonne over Phase II (upgraded from €19.5/MWh that we were forecasting in February this year).
- **We raise our capital cost assumption.** A dramatic increase in the price of raw materials, labour cost and delays in power station components all add to the capital costs within our new entrant assumptions (CCGT €550/kW to €650/kW, Coal €1000/kW to €1350/kW). Whilst this has a relatively small effect to our new entrant price assumptions (c.£1.5/MWh), it does add further momentum to the power price story
- **We forecast coal price strength to continue.** The price of international coal delivered to North West Europe has increased by some 65% in just over 12 months. Coal prices are now at the highest levels seen for 20 years. Our analysis suggests little reason for a sharp reversion in prices. This is largely based on our view of coal freight rates. Although freight rates have increased sharply since May (as highlighted by our note *UK utilities: Steady as she goes* – May 2007), we believe the retirement of aging fleet will ensure that supply demand remains tight over the coming years
- **Hence, we increase our new entrant price estimate**. Assuming long-term oil prices of $70/bbl real ($77/bbl nominal by 2012) we see new entry prices at €62/MWh real (€65/MWh nominal by 2012).
- **The chart below shows the impact on 2008 earnings of an increase in achieved electricity price of €1/MWh**. British Energy is highly geared to an increased power price but the technical issues inherent in its AGR fleet present too many risks for investors, in our view. International Power's gearing to electricity prices is exaggerated since some of the benefit from an oil-price related power price increase would be offset by cost increases from its mainly gas-fired power stations.

Effect of €1 /MWh increase on 2008 EPS

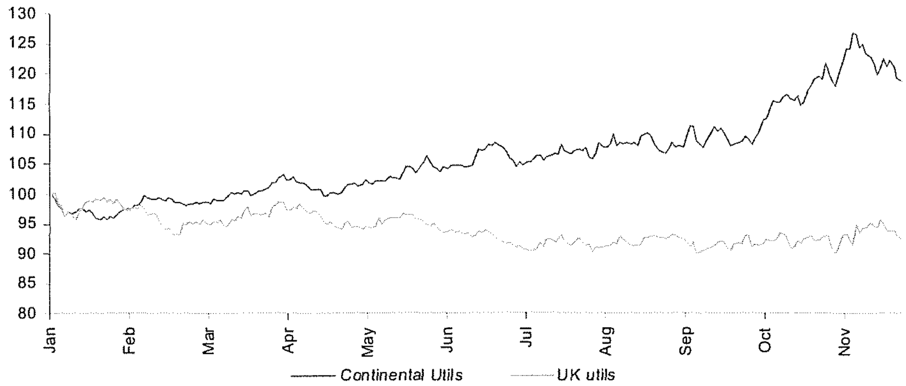


Source: Dresdner Kleinwort Research estimates

- **M&A may add to the sector's attractiveness**. The GDF-Suez merger and E.ON's acquisition of Endesa Europe/Viesgo should close in 2008. In addition to that, the Spanish general elections in March could bring about more corporate activity, as could Italian municipal consolidation and the seemingly unrelenting appetite for UK infrastructure assets

- **As we did for 2007, we expect the UK utilities sector to underperform the Continental utilities sector** as the UK's relative fundamental valuations seem stretched. The UK utilities have underperformed the Continent by 26.5% year to date (as forecasted by our note *Utilities outlook for 2007 – The party is over*). We believe that only further M&A in the UK could reverse this trend.

Relative performance of Continental Utilities versus UK over 2007 to date



Source: RIMES

- **From growth to re-rating**. An uncertain market is likely to result in an upward re-rating of the relatively predictable earnings stream that both competitive and regulated utilities offer over the next couple of years. This adds further to our positive stance on the sector.

- **We raise our sector stance from Neutral to Overweight**. Our favoured power price plays are **RWE**, **EDF** and **E.ON** and we also see value in **Enel** and **Enagas**.

Which way for power prices?

Two of the major factors behind the sector's bull-run over the last eight years were low interest rates and the first major upswing in the long-term European power price cycle. Shortly after the liberalisation of the European power market, prices reached short-run marginal cost (theoretically the "absolute" low for power prices), which at the time was around €20/MWh. As insufficient spark/dark spreads forced capacity out of the market, power prices started to rise again. However, so did coal- and gas prices, the cost of CO_2 and the capital cost for building new plants, which were driven up by Chinese demand. As a result new entry cost managed to stay ahead of new entry prices. This resulted in a steady, almost predictable series of earnings upgrades for the power price plays in the sector.

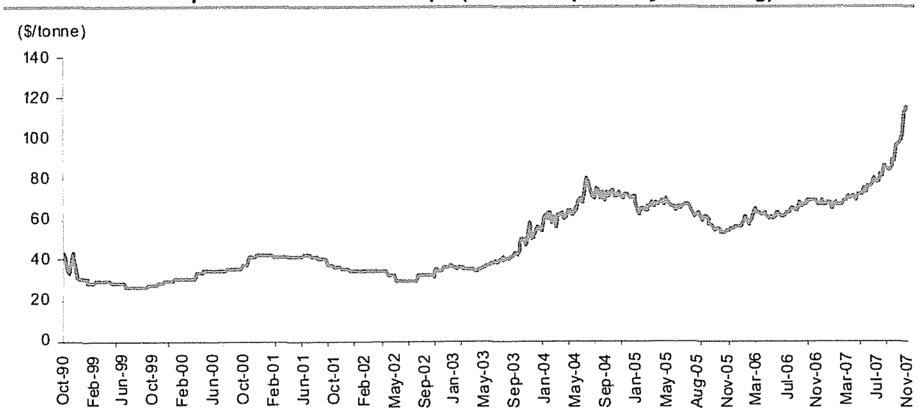
However, this predictability could be about to change. The recent spike in oil and coal prices has taken forward curves to levels that are not necessarily a good reflection for long-term price expectations. For example, we doubt that many utilities are assuming long-term oil prices of $80/bbl when assessing the economic viability of new CCGT's. Nevertheless, a number of power plant projects have been cancelled recently citing rising costs. By using commodity prices indicated by the forward curve and assuming a dramatic increase in capital cost it is quite easy to get to power prices above €70/MWh. But is this realistic? Below we examine where we believe current new entry costs are – looking at the different relevant elements.

Coal prices soar

The price of international coal delivered to North West Europe has increased by some 65% in just over 12 months. The increase in the price has been accelerating in recent weeks. Coal prices are now at the highest levels seen for 20 years. This has only partly been mitigated by the weakness of the US dollar against the euro and sterling. Our analysis suggests little reason for a sharp reversion in prices.

Ten years ago coal prices (for generation) in Europe were set mostly by domestic production, with imported coal at the margin. However, international coal delivered to North West Europe has become increasingly important, both in volume terms and as a determinant for the market price for domestic coal. The chart below shows the market price for international coal delivered to North West Europe. In Amsterdam, Rotterdam and Antwerp (ARA), prices have been cyclical, with an overall upward trend since 1990.

International coal price delivered to Europe (ARA coal price 1 year rolling)



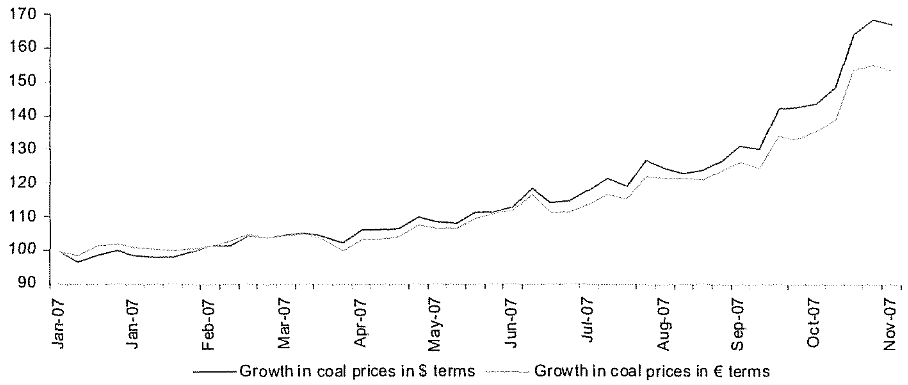
Source: Reuters

Coal prices have soared in recent months

The chart shows that there has been an extremely sharp upward move in the ARA coal price over the last year, accelerating over the last few months.

The price is now higher than at any time since the 1980s. The weakness of the dollar has partly mitigated the upward move. However, even in euros the coal market price has increased from €54/tonne to €79/tonne (+46%) in just over 12 months (as the US$:€ rate has gone from 1.28 to 1.45 over the period).

Growth in coal prices in $ and € terms



Source: Reuters

Why have coal prices risen?

Increasing freight rates and Asian growth has pushed up the price of international coal delivered to Europe. The following tables show how freight and physical coal prices from different locations have moved. These can be added to get an idea of how the coal prices into Rotterdam from various regions have moved.

Freight rates to Rotterdam

($/tonne)	01/01/2006	01/01/2007	01/11/2007	Difference	Growth (%)
Rizhao to Rotterdam	14 3	25 0	63 6	38 6	254
Hampton Roads to Rotterdam	12 5	18 5	44 0	25.5	238
Bolivar to Rotterdam	12.5	19 0	47 5	28 5	250
Queensland to Rotterdam	16 3	29 5	64.3	34 8	218
Richard's Bay to Rotterdam	11 3	21 3	50.4	29.2	237
US Gulf to Rotterdam	13.5	18 5	45 5	27 0	246
Maracaibo to Rotterdam	15.9	25 3	65 9	40 7	261
Gandsk to Rotterdam	6.4	8.2	17.8	9.7	218
Average	12.8	20.6	49.9	29.2	

Source: Reuters

Physical coal prices

($/tonne)	01/01/2006	01/01/2007	01/11/2007	Difference	Growth (%)
Newcastle, Australia	36.6	51 8	78.0	26 3	151
Richards Bay, South Africa	41.8	51 1	80 4	29 3	157
Qinhuangdao, China	46.5	59 0	75.0	16 0	127
Japanese Reference Price, China	58.6	54 8	67 9	13 1	124
Puerto Bolivar - ARA, Columbia	44.0	52 0	76 0	24 0	146
Gdansk, Poland	48 0	63 8	74 0	10 3	116
Vostochny, Russia	47.0	58 0	75 0	17 0	129
Baltic, Russia	39 1	65 0	92 5	27.5	142
Maputo, Mozambique	41.0	48.9	73.9	25.0	151
Average	44.3	55.7	74.8	19.1	

Source: Reuters

Total coal prices to Rotterdam

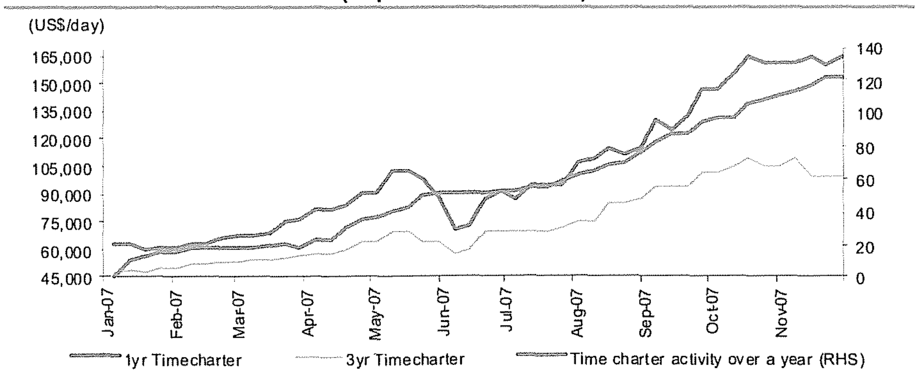
($/tonne)	01/01/2006	01/01/2007	01/11/2007	Difference	Growth (%)
China	60 8	84 0	138 6	54 6	165
Japan	71 1	73 3	111 9	38 6	153
Columbia	56 5	71 0	123 5	52 5	174
Australia	52 9	81.3	142 3	61 0	175
South Africa	53 0	72 3	130 8	58 4	181
Poland	54.4	71.9	91.8	19.9	128
Average	57.5	76.7	126.8	50.2	165

Source: Reuters

What has driven freight rates up?

The following chart indicates how the bulk carrier time charter market (for Capesize vessels which are used for coal transportation) has also responded since the beginning of the year. These are agreements for use of bulk carrier services for a certain period of time. The chart shows that the costs (on an average US$/day basis) for Capesize bulk carriers has increased significantly for one-year and three-year periods. The right-hand scale of the chart shows the number of trades (for trades > 1 year) for Capesize vessels.

Bulk carrier time charter market (Capesize bulk carriers)



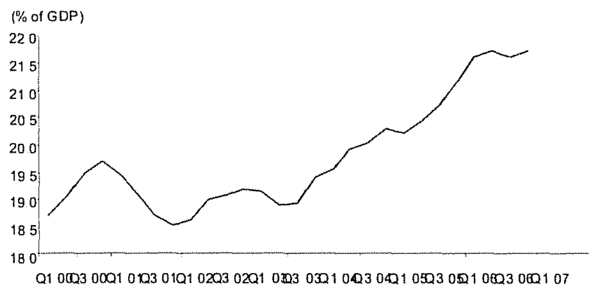
Source: Clarkson research services limited

So, the second hand value of five-year old Capesize vessels has increased from US$81m at the end of 2006 to US$152m. This compares with new building prices (for delivery in 2009/10) that have increased from US$68m to US$96m at the end of 2006. In our view this has been driven by the following issues:

Favourable demand dynamics

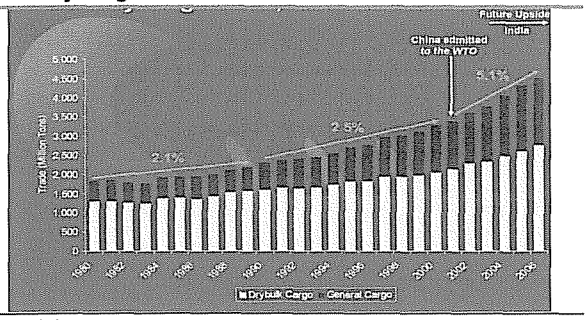
Overall the need for shipping and port infrastructure has been on an upward trend as general world trade has increased. The following top left chart below shows how G7 (Canada, France, Germany, Japan, Italy, United Kingdom and United States) trade has increased over the last seven years. This has had its impact on the World dry cargo market (see top right chart below).

G7 trade



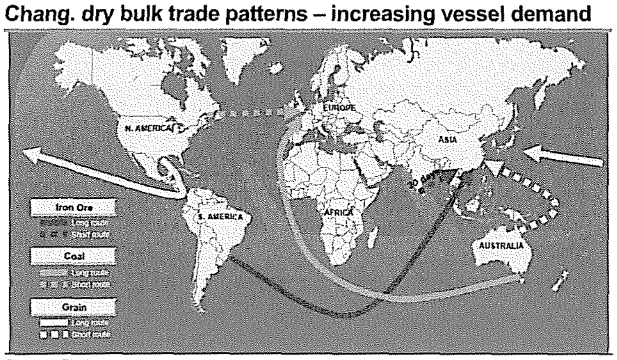
Source: Thomson Financial

World dry cargo trade 1980-2006



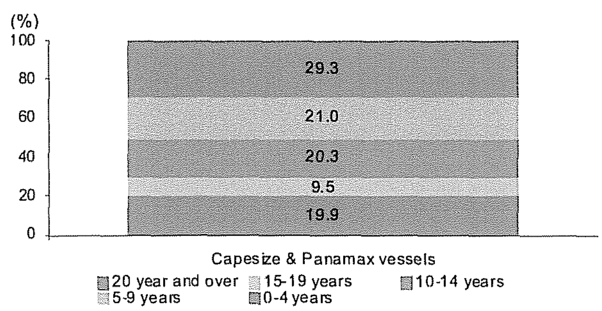
Source: Clarkson

Chang. dry bulk trade patterns – increasing vessel demand



Source: Clarkson

Panamax Capesize vessels – age of fleet



Source: Clarkson

In addition, global trade patterns of the dry bulk market have been impacted by the trade patterns of China and India. Rapid urbanisation and the industrialisation of India (industrial production growth rate of 17.6%) and China (industrial production growth rate of 11%) have driven steel and electricity consumption. This impacts the dry bulk market because it increases demand for thermal and coking coal. This is shown in the bottom left chart above. Emerging countries now contribute to over half of world GDP. Furthermore, the IMF estimates that emerging countries will grow at a rate of 6.8% pa for the next five years.

Whilst the demand side has been growing strongly, the supply side has had insufficient investment, which has caused further constraint in the market places. In addition the bottom right chart above shows that the existing dry bulk fleet is becoming old – with 14% above the design maximum age.

Port congestion continues to be a significant factor

Queues at Newcastle weigh on Australian exports

To add to freight's problems, the high demand and a shortfall of export capacity have meant that the number of ships queuing up at Newcastle Port (Australia) and other ports has increased rapidly this year. In February 2007, the Newcastle port authorities re-introduced (after scrapping it in September 2006) a quota system to try and reduce vessel queues and waiting times. This system gives coal producers a flexible monthly export quota (linked to demand). The net effect of the quotas is a reduction in shipments, particularly from large producers. In May 2007, Newcastle port cut allocations for all producers to try and ease the continued ship congestion. The congestion at the port has caused buyers to look to countries other than Australia, seeking instead Indonesian sources of coal. It is worth noting that Australia is one of the largest exporters of coal globally.

Supply and demand remains tight

The Bulk carrier time charter market is the key indicator for future freight prices. The above chart shows the one-year time charter for a Capesize vessel stands at $165,000 a day whilst the three year time charter stands at $100,000 a day. To remove the potential of arbitrage this implies that the time charter for years two and three must average $68,325 a day. This has to occur such that the average for all three years remains $100,000/day. $68,325 a day is broadly in line with our view of the daily earnings required for new entrant freight vessel.

Freight (average implied for years 2 and 3)

	1yr time charter	3yr time charter	Average implied time charter over years 2 and 3
Average earnings $ per a day	165,000	100,000	68,325

Source: Dresdner Kleinwort Research

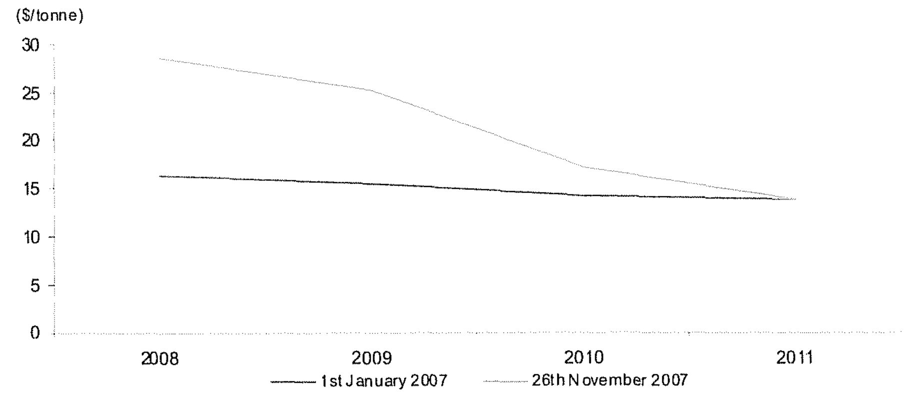
New entrant freight rate

	$m	$/day
Depreciation	4.5	12,363
O&M	3.7	10,000
Capital	14.3	39,041
New entrant freight rate	22.4	61,404

Source: Dresdner Kleinwort Research

This rapid fall in the freight rate shown above is also reflected in the ARA coal market. This is shown by calculating the implied freight price from Richards Bay (only forward curve of physical prices available), which is done in the first chart overleaf. In both cases, we believe this level of reversion is overly aggressive given the tight supply demand balance of the freight market.

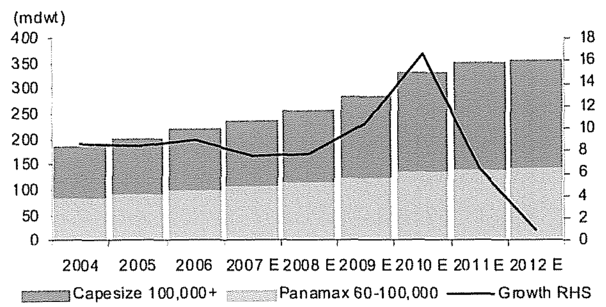
Implied freight for coal from Richards Bay to Antwerp, Rotterdam and Amsterdam



Source: Reuters, Dresdner Kleinwort Research

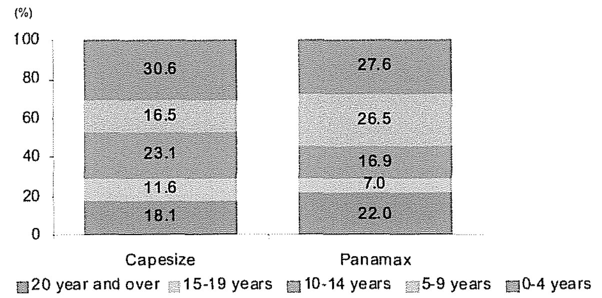
The chart on the left below shows the future evolution of the Capesize and Panamax vessels in million of tonnes of dry weight. These are the vessels that are primarily used to transport coal, iron and grain from location to location. As this shows there is aggressive growth in supply in 2009 and 2010. However, this fails to take into account the age of the existing fleet.

Growth of Capesize and Panamax vessels



Source: Clarkson

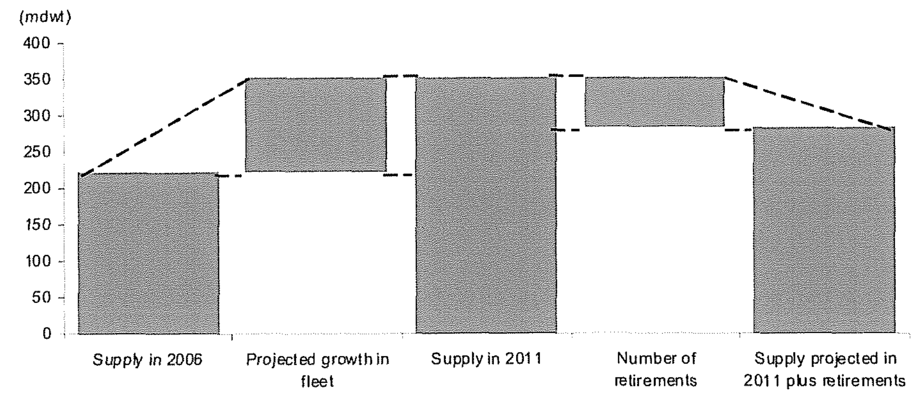
Dry bulk vessels – supply versus aging fleet



Source: Clarkson

The right-hand chart above shows the age profile of the existing Panamax and Capesize fleet. As the chart shows, around a fifth (18% for Capesize, 22% for Panamax) of the fleet has surpassed its design maximum with a further 9% (12% for Capesize, 7% for Panamax) approaching this maximum of 20 years over the next 5 years. Taking these retirements into account, the per annum growth over the next 5 years is 5%.

Supply with the Panamax and Capesize market



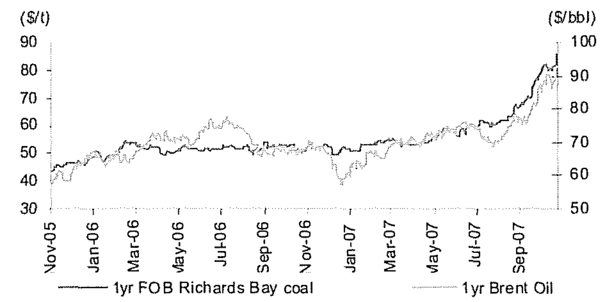
Source: Clarkson, Dresdner Kleinwort Research

5% per annum supply growth compares to per annum World Seabourne trade demand growth (for Steam Coal, Coking coal and Iron ore) over the last three years of 8.4%. Our view is that this demand growth will continue (see section below) which should give greater strength to future freight rates than currently implied by the market. This should offer further support to near/medium term ARA coal prices.

What has driven physical coal prices up?

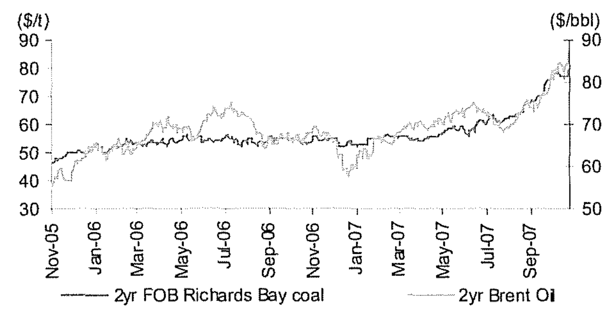
The most obvious potential driver for the increase in the coal price is the upward movement that we have seen in crude oil prices. Crude oil remains the primary driver for energy prices worldwide. The following charts show the correlation of forward coal prices (physical coal prices from Richard's Bay in South Africa) and forward Brent oil prices.

1 yr FOB Richards Bay coal versus Brent oil



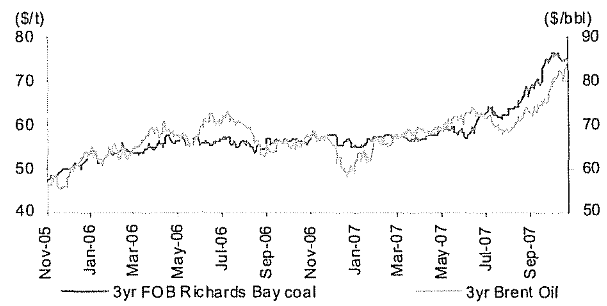
Source: Dresdner Kleinwort Research, Reuters

2 yr FOB Richards Bay coal versus Brent oil



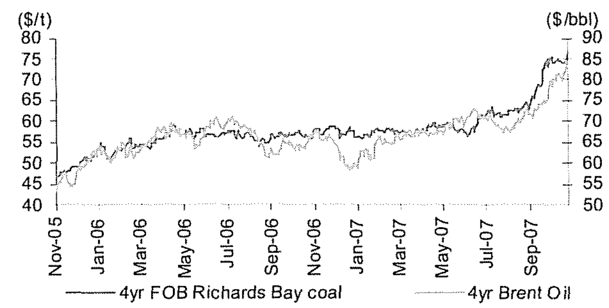
Source: Dresdner Kleinwort Research, Reuters

3 yr FOB Richards Bay coal versus Brent oil



Source: Dresdner Kleinwort Research, Reuters

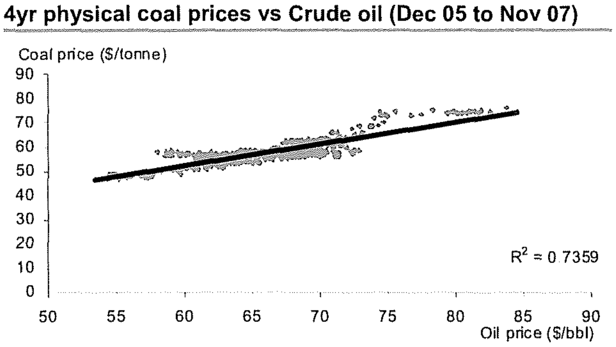
4 yr FOB Richards Bay coal versus Brent oil



Source: Dresdner Kleinwort Research, Reuters

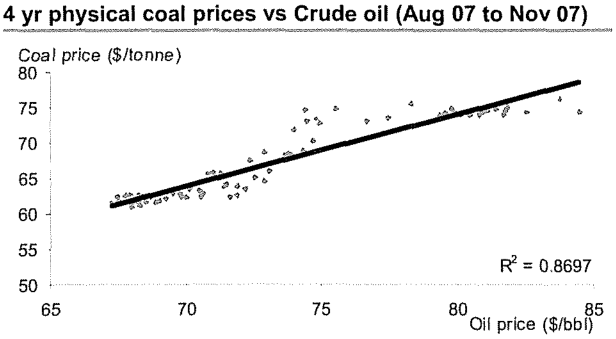
As the chart below shows the correlation is fairly strong between the long-run oil price and the long-term physical coal price with an R^2 over 70% for both regressions. (Again we have used free on board coal from Richards Bay as a proxy for physical coal prices).

4yr physical coal prices vs Crude oil (Dec 05 to Nov 07)



Source: Dresdner Kleinwort Research, Reuters

4 yr physical coal prices vs Crude oil (Aug 07 to Nov 07)



Source: Dresdner Kleinwort Research, Reuters

There is logic to this relationship as both oil and coal have been affected by growth in the emerging markets due to rapid urbanisation and industrialisation. This has driven the demand for primary energy. While seen as competing resources when considering power generation (Oil/gas fired versus coal generation), the overlap is by no means perfect.

To help assess some of the coal-specific drivers it is worth looking in more detail at the key net coal exporters. The chart below shows coal production net of consumption for 2004 and 2005. Clearly Australia is a key exporter, with Indonesia, South Africa, Columbia, the US and increasingly China also being important players.

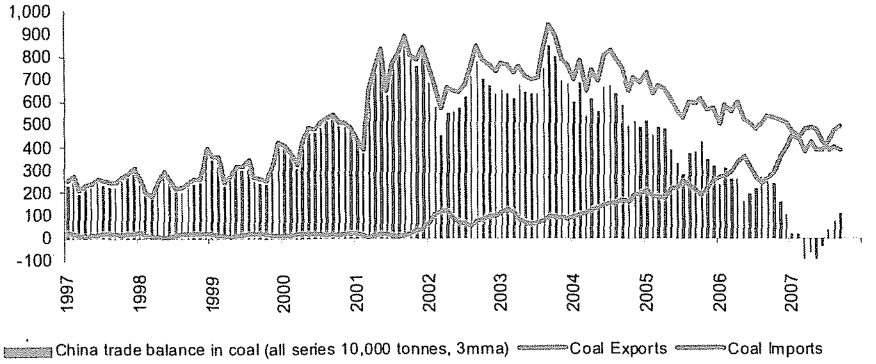
Main producers, consumers and exporters of coal

		Production		Consumption		Export	
		2004	2005	2004	2005	2004	2005
USA	Mt oil equivalent	568	576	566	575	2	1
Russian Federation	Mt oil equivalent	129	137	107	112	22	25
South Africa	Mt oil equivalent	137	139	95	92	42	47
Australia	Mt oil equivalent	197	202	52	52	145	150
China	Mt oil equivalent	1007	1108	978	1082	29	26
India	Mt oil equivalent	191	200	204	213	-13	-13
Total	*Mt oil equivalent*	2229	2362	2002	2126		
World	Mt oil equivalent	2751	2887	2799	2930		

Source: BP

China's exports have been growing in recent years but remain smaller than those of Australia or South Africa. However, this simple chart hides an important point. The table below shows the production and consumption figures rather than just the net balance. Although net exports from China are smaller than Australia, Indonesia and South Africa, the absolute figures for both production and consumption in China are very large. As its exposure to the world market increases, small percentage changes in either production or consumption can have a big impact on world coal supply. The decline of exports has been attributed to strong demand from the domestic market and the introduction of export tariffs on coal products from the end of 2006.

China trade balance in coal

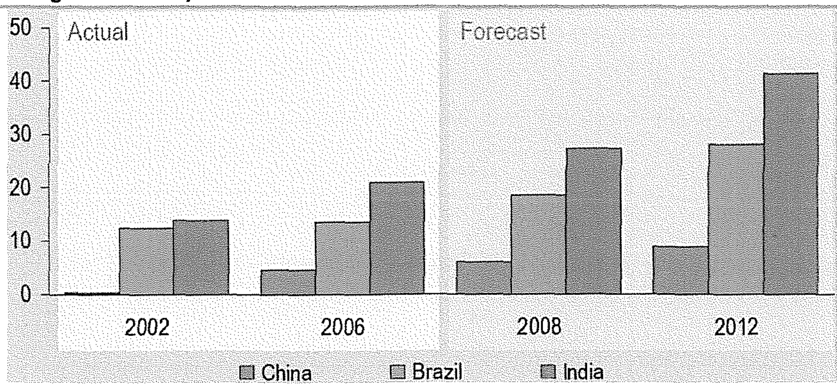


Source: Thompson Datastream

Growth of metallurgical coal from China, Brazil and India set to continue...

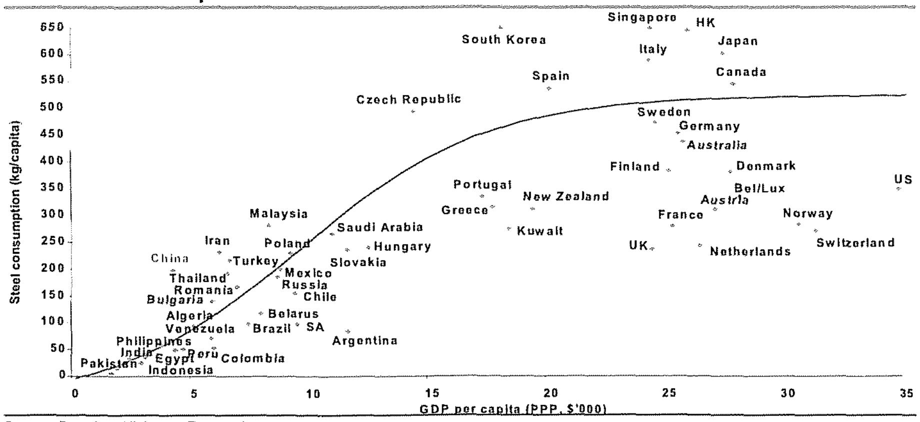
Demand growth in China, and much of the rest of South East Asia, has indeed proved stronger than expected in 2006. General growth has been compounded by an increased demand for coal for steel production. This demand is expected to remain strong for the coming years. The following chart shows expected growth of metallurgical coal from China, Brazil and India. As the chart shows this is expected to strengthen over the next five years. Following this is the international spectrum chart for steel which shows China, Brazil and India's consumption still in its infancy compared to that of a developed country.

Metallurgical Coal imports 2002 to 2012 – India/Brazil/China



Source: AME Outlook report for Export Met Coal

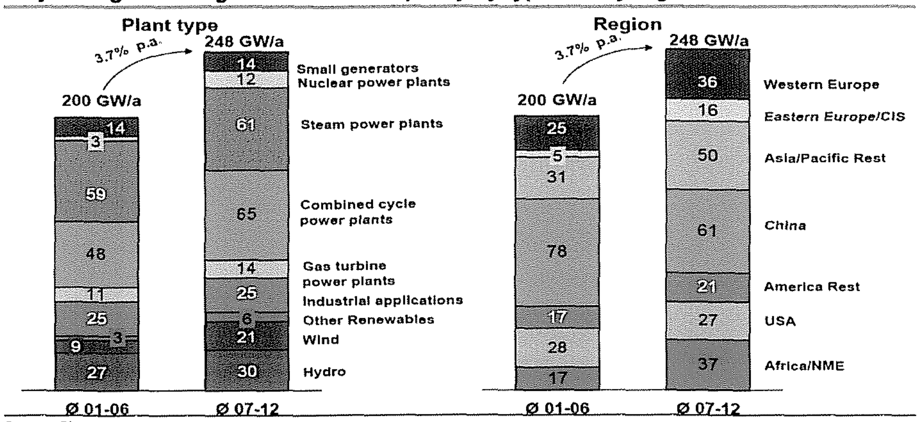
The international spectrum chart for steel



Source: Dresdner Kleinwort Research

In addition, steam coal (coal used in power generation) has been strongly driven by the growth of the power generation market. Whilst some of this is replacement capital spend, the growth is expected to remain robust for the coming years (steam coal generation growing at 61GW a year for the next five years).

Projected growth in global installed capacity by type and by region



Source: Siemens

In summary we believe that the underlying dynamics that are driving the physical coal price up this year seem robust and look set to remain strong for the short to medium term.

CO_2 update

For Phase II we forecast a deficit of 1,436 $MtCO_2$ over 2008-2012, which in our view is unlikely to be met by industrial response and CDM/JI supply. We estimate that 136 $MtCO_2$ of fuel switching abatement will be needed from the generation sector. On our commodity assumptions this translates to an average clearing price of €25.0/tonne over Phase II (upgraded from €19.5/MWh).

Swings and roundabouts

Final NAP decisions are in

The National Allocation Plans (NAPs) determine the total quantity of CO_2 emission allowances that Member States grant to their companies, which can then be sold or used by the companies themselves. These allowances are free and represent the emissions target that the Member State intends to meet over the phase. The level to which the CO_2 market is constrained is determined by the projected emissions over the period minus the number of free CO_2 permits allocated. This represents the level of CO_2 reduction needed in total across the EU. The following chart gives a comparison of our estimates for Phase II allocations in our February edition *"Carbon Derby: Phase I is dead, long live Phase II", February 2007* versus the EC's final Cap decisions.

Comparison for EC decisions versus Dresdner Kleinwort estimates

Country	February Total Phase II Allocation - DK estimate ($MtCO_2$/yr)	Total Phase II Allocation – EC decision ($MtCO_2$/yr)	Difference ($MtCO_2$/yr)
Austria	29.0	30.7	-1.7
Belgium	58.5	58.5	0.0
Bulgaria	56.0	42.3	13.7
Cyprus	6.2	5.5	0.7
Czech Republic	85.5	86.8	-1.3
Denmark	25.0	24.5	0.5
Estonia	11.6	12.7	-1.1
Finland	31.6	37.6	-6.0
France	138.2	138.2	0.0
Germany	453.1	453.1	0.0
Greece	69.1	69.1	0.0
Hungary	25.3	26.9	-1.6
Ireland	21.2	22.3	-1.1
Italy	186.1	195.8	-9.7
Latvia	3.3	3.4	-0.1
Lithuania	8.8	8.8	0.0
Luxembourg	2.7	2.5	0.2
Malta	2.1	2.1	0.0
Netherlands	85.5	87.1	-1.6
Poland	200.3	208.5	-8.2
Portugal	33.9	34.8	-0.9
Romania	73.7	75.9	-2.2
Slovakia	30.9	30.9	0.0
Slovenia	8.3	8.3	0.0
Spain	138.0	152.3	-14.3
Sweden	22.8	22.5	0.3
UK	246.2	246.2	0.0
EU 27	2053	2087	-34.4

Source: NCF, Dresdner Kleinwort Research estimates

As the table shows the EC cap decisions were generous by 34$MtCO_2$ pa (or 170 $MtCO_2$ over the Phase II period of 2008-2012) when compared to our estimates.

The following bullet points summarises the main changes:

- **Spain (-14.3MtCO_2).** With the European Commission's decision it came to light that Spain had increased its Phase I allocation by 6.7MtCO_2 compared to the figures represented in Phase I NAP due to a broadening of the scheme's coverage (reinterpretation of the definition of combustion installation by Spain). The remaining difference was due to the Commission accepting a higher allowance level than expected to be consistent with the country's Kyoto target.

- **Italy (-9.7MtCO_2).** The European Commission enforced a 13.2MtCO_2 reduction in the proposed 209MtCO_2 cap, bringing the total permitted free allocation to 195.8MtCO_2. This cut is considered necessary as the Commission viewed the proposed cap as being inconsistent with Italy's commitments under the Kyoto Protocol. In its assessment of Italy's proposed policies and measures for emission reductions in sectors not covered by the Emissions Trading Directive, the Commission believes a number of measures to be unsubstantiated. This primarily concerns measures in the transport sector and those focused at energy efficiency improvements. This lack of substantiation has led the Commission to believe that a total emission reduction of 34.2MtCO_2/yr will not be achieved. To ensure that the country is still on track with its Kyoto target, these emission reductions are expected to be achieved elsewhere and the EU ETS will have to share in that burden. This resulted in a reduction of the requested EU ETS cap by 13.2MtCO_2 per year (38.5%). This reduction was less than anticipated.

- **Finland (-6.0MtCO_2).** This reduction is less than expected as we had anticipated the cap to be reduced to 31.6MtCO_2/yr, equal to the original 2010 emission projections. This difference has produced an increase in allocation of 6MtCO_2/yr or 30MtCO_2 over the Phase and has arisen from the Commission's acceptance of Finland's claims that 2005 emissions were anomalously low due to below-average power production in the country. Emissions were claimed to be abnormally low due to the ample hydro situation in Finland, combined with a large increase in net import to the Finnish grid due to similarly good hydro conditions in the rest of Scandinavia – leading to a decrease in thermal power generation. In order to account for this, the Commission added 6MtCO_2 to the 2005 verified emission data, which has consequently also increased the 2010 projections by a similar amount.

- **Poland (-8.2MtCO_2).** The total cap for Poland has been set at 208.5MtCO_2/yr compared to our estimate of 200.3MtCO_2/yr. Poland had however included an additional 6.3MtCO_2/yr of emissions from other combustion installations for Phase II at the Commission's suggestion. As this was not included in our previous projections, our equivalent central value was 206.6MtCO_2/yr. This decision has led to a decrease of 10Mt in our Phase II demand projections.

- **Bulgaria (+13.7MtCO_2).** Allocation for Bulgaria underwent substantial cuts as the Commission reduced the cap by 37% from 67.6MtCO_2/yr to 42.3MtCO_2/yr. This was much stricter than anticipated due to different 2005 emissions data used by the Commission in its assessment, resulting in a cap that was 13.7MtCO_2/yr less than our in-house estimate. This has therefore increased demand by 68.5MtCO_2 over the Phase.

Norway and Aviation to enter EU ETS

Norway

The Norwegian Ministry of Environment submitted a bill to parliament (Storting) on 25 May for linking the Norwegian Emissions Trading Scheme to the EU ETS from 2008 onwards.

The Norwegian scheme was designed to assist the country in its drive to meet their Kyoto target and is currently already in operation; the first phase (2005-2007) covers around 10% of the country's emissions and the second (2008-2012) will be expanded to over 40% of emissions. The expansion will include offshore installations belonging to the oil and gas industry and a selection of onshore installations.

In addition to these finalised caps in the previous section, Norway also released a final draft cap for their inclusion in Phase II of the EU ETS. The proposed cap has been set at 15MtCO_2/yr.

The legal aspects of the link have now also been approved by the other countries involved in the European Economic Area and the linking of the Norwegian scheme and the EU ETS can now be set in legislation. Taking into account both the allocation decisions and incremental demand caused by the inclusion of Norway, the total net demand (i.e. emissions less allowances) increases by 8.1MtCO_2 pa (or 40.5MtCO_2 over the Phase II period of 2008-2012).

Aviation taking off from 2010

In November, the European Parliament (EP) endorsed the Commission's proposal to include the aviation sector in the EU emissions trading scheme. The EP also made a number of important changes to the Commission's proposal. Following reviews by the Parliamentary Transport and Environment Committees, the Parliament as a whole has proposed the following amendments:

- All flights to come under the EUETS in 2011 – the original proposal included only intra European flights in 2011 with all departing and arriving flights coming in in 2012.
- A greenhouse gas multiplier of 2 meaning that two permits will have to be bought for every tonne of carbon that is emitted over the cap – the previous proposal had no multiplier.
- A cap calculated using 90% of historic emissions from an average of the period 2004-2006 – the previous proposal suggested a cap of 100% the base line emissions.
- The amount of offset credits (EUA, ERU, CER) that can be used by the aviation sector will be 'harmonised' – effectively confirming that some limit will be applied but deferring more detailed design decisions.
- 25% of allowances shall be auctioned – the previous proposal only suggested that the level of auctioning should be consistent with the average proportion of allowances set aside for auctioning in Phase II.

In summary, the Parliament's proposals would lead to an increase in demand from the aviation sector in Phase II of some 140MtCO_2. We do not believe however that all the changes suggested by the Parliament will be accepted by the council of Ministers. We assume that inclusion of Aviation, increases our total net demand (i.e. emissions less allowances) by 60.6MtCO_2 over 2008-2012.

Net demand

The following table display our net demand estimates and underlying commodity assumptions:

Phase II EU ETS net demand (MtCO_2)

	2008E	2009E	2010E	2011E	2012E
EU 27	294.9	201.6	223.0	215.1	229.7
Norway	8.4	7.4	7.8	8.3	8.7
Aviation	-	-	-	21.6	39.1
EU27 + Norway + Aviation	303	209	231	245	277

Source: NCF, Dresdner Kleinwort Research estimates

New commodity assumptions

Real		2008E	2009E	2010E	2011E	2012E
Oil	$/bbl	80	75	72.5	70	70
Coal	$/tonne	100	90	85	80	70
Continental gas	p/therm	43.5	41.1	39.8	38.6	38.6
UK premium	p/therm	-3.0	-2.0	-1.0	0.0	0.0
UK gas	p/therm	40.5	39.1	38.8	38.6	38.6

Source: Dresdner Kleinwort Research estimates

Supplementary limits

The Emissions Trading Directive (under what is known as the "Linking Directive") allows operators of installations within the EU ETS to purchase emission credits through trading emissions internationally under the Kyoto Protocol or from emission-saving projects carried out in third countries under Kyoto's flexible project-based mechanisms. This allows Member States to invest in CDMs (emission reduction schemes in developing countries without an emission reduction target, e.g. China, India) and JIs (emission reduction schemes in industrialised countries with emission reduction targets, eg Russia, Ukraine) to comply with part of their emission reduction commitments. Member States are required to ensure that the use of Kyoto project credits is supplemental to domestic action – ie must be consistent with Member State commitments to "supplementarity" and has to be fixed in the National Allocation Plan. The following table gives a comparison of our estimates for Phase II supplementary limits in our February edition *"Carbon Derby: Phase I is dead, long live Phase II", February 2007* versus the EC's final supplementary limit decisions.

Comparison for EC decisions versus Dresdner Kleinwort estimates

Country	February Forecast limit of use of CER/ERUs (%)	Limit of use of CER/ERUs (%)	Difference (%)
Austria	20	10	-10
Belgium	10	8	-2
Bulgaria	10	13	3
Cyprus	10	10	0
Czech Republic	10	10	0
Denmark	28	17	-11
Estonia	10	10	0
Finland	12	10	-2
France	9	14	5
Germany	20	20	0
Greece	9	9	0
Hungary	10	10	0
Ireland	22	10	-12
Italy	25	15	-10
Latvia	10	10	0
Lithuania	12	20	8
Luxembourg	10	10	0
Malta	10	10	0
Netherlands	10	10	0
Poland	10	10	0
Portugal	10	10	0
Romania	10	10	0
Slovakia	7	7	0
Slovenia	16	16	0
Spain	34	20	-14
Sweden	10	10	0
UK	9	9	0
EU 27 ($MtCO_2$)	315	289	26

Source: NCF, Dresdner Kleinwort Research estimates

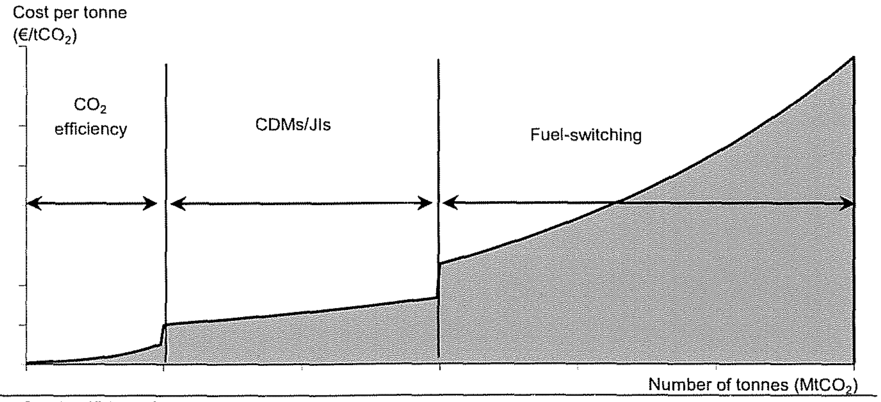
We estimate a maximum of 260Mt/yr CDM/JIs credits over 2008-2012

This cap is particularly important as it relates to the total theoretical maximum level of CDM/JIs credits that can brought into the scheme. The majority of countries have opted for these credits to be imported on an installation level basis.

As not all companies are likely to actively participate in trading (especially small sized firms), it can be expected that the maximum import of CDM credits may only be in the range of 75-90% of the total cap. Hence for the purposes of our modelling we assume that 90% of our expected maximum cap is imported into the EU ETS – ie, a maximum of 260Mt/yr or 1300mt (=0.90*5*289) over 2008-2012.

What are the CO_2 abatement options for Phase II?

Categories of CO_2 abatement (illustration)



Source: Dresdner Kleinwort Research

There are four main types of abatement options for Phase II:

- **CO_2 efficiency:** Industrial production can be made more efficient in terms of its CO_2 emissions. However, the overall abatement that can be achieved via this option is limited.
- **CDM/JI credits:** The Linking Directive allows operators of installations to purchase emission credits through international emissions trading under the Kyoto Protocol or from emission-saving projects carried out in third countries under Kyoto's flexible project-based mechanisms. This allows CDMs (emission reduction schemes in developing countries without an emission reduction target, eg. China, India) and JIs (emission reduction schemes in industrialised countries with emission reduction targets, eg. Russia, Ukraine) to be brought into the EU ETS.
- **DSM: Stopping CO_2 intensive processes.** The scale of the industrial response or demand side management (DSM) will be dependent on the CO_2 price – ie, hardly present at €10/tonne but very significant at €30/tonne. However, this option is dependent on the CO_2 price, instead of setting it, and hence is not part of our abatement curve.
- **Fuel switching:** This is the process whereby more CO_2 intensive power stations generate less electricity than less CO_2 intensive power stations. For example, coal generation stations reduce their output and are replaced by gas fired stations. This process creates a CO_2 saving (remember on average gas only emits around 0.35t CO_2 per MWh compared to coal that emits 0.9 tCO_2 per MWh). Our projections for fuel switching use the following commodity assumptions.

New commodity assumptions

Real		2008E	2009E	2010E	2011E	2012E
Oil	$/bbl	80	75	72.5	70	70
Coal	$/tonne	100	90	85	80	70
Continental gas	p/therm	43.5	41.1	39.8	38.6	38.6
UK premium	p/therm	-3.0	-2.0	-1.0	0.0	0.0
UK gas	p/therm	40.5	39.1	38.8	38.6	38.6

Source: Dresdner Kleinwort Research estimates

What is in the CDM/JI pipeline?

There are over 2,647 projects that are in the UN approval process. The projects submitted to date have a heavy weighting towards renewables and HFC typed investments. Furthermore, a large portion of the CDM pipeline comes from either China or India.

CDM and JI projects

CDM projects		February 2007	November 2007	Change since February
UNEP/UNFCCC pipeline				
Number of projects		1586	2647	1061
Total 2012 CERs	$MtCO_2$	1777	2273	496
Of which Registered				
Number of projects		492	839	347
Total 2012 CERs	$MtCO_2$	760	1097	337
Of which Issued				
Number of projects		123	262	139
Total 2012 CERs	$MtCO_2$	28	92	64
JI projects		February 2007	November 2007	Change since February
UNEP pipeline				
Number of projects		154	199	45
Total 2012 CERs	$MtCO_2$	134	208	74
Of which track II				
Number of projects			93	
Total 2012 CERs	$MtCO_2$		155	
CDM and JI projects		February 2007	November 2007	Change since February
Number of projects		1740	2846	1106
Total 2012 CERs + ERUs	$MtCO_2$	1911	2481	570

Source: NCF, Dresdner Kleinwort Research

The quantity of risk-adjusted credits that we expect to be generated and issued up to March 2013 is currently 2,497$MtCO_2$. The supply of CDMs and JIs is to be split between governments, Japanese and Canadian entities, and the EU ETS, as well as banking into a subsequent period by governments or intermediaries. We currently estimate that 1050 $MtCO_2$ are purchased by governments, purchased by other entities, or banked. As a result, we calculate that 1,372Mt will be available to EU ETS participants.

Phase III – a big driver for Phase II?

Although little is known about Phase III, the potential impact of upcoming news flow on the Phase II CO_2 price is significant. To date we believe that banking (ie, the carry-over) of CO_2 allowances from the second to the third trading period will be allowed. If correct, this will help harmonise the price between Phase II and Phase III CO_2 prices.

As required by the Emissions Trading Directive, the Commission is reviewing the Directive in the light of experience gained in the first trading period 2005-2007. The Commission set out its agenda for the review in a Communication published on 13 November 2006 (see IP/06/1548). The review is being conducted in the framework of the European Climate Change Programme (ECCP) and involves all relevant stakeholders through a working group. This working group was asked to submit a report by 30 June 2007. The following are some of the key issues that have been discussed and the assumptions that we have made within our forecasts:

Coverage

At the ECCP meeting on the scope of the EU ETS Phase III, proposals were put forward for the inclusion of:

- Other industrial sectors:
  - CO_2 from petrochemical and chemical production processes
  - CO_2 from aluminium production
  - N_2O from the production of nitric acid and adipic acid
  - Methane emissions from coal mines
- Aviation
- Road transport
- Shipping
- Expansion with other trading schemes: eg Croatia, Switzerland

Currently we assume that only aviation and Norway will certainly be included in Phase III and the phase will therefore have exactly the same coverage as in 2012.

Allocation

Since the Energy Review Report in 2006, the European Council agreed in March 2007 to a common European strategy for energy security and tackling climate change. This includes further steps to complete the internal market in gas and electricity, and endorsement of the objective to save 20% of the EU's energy consumption in 2020 compared with current projections. The agreement commits the EU to a binding target of reducing greenhouse gas emissions by 20% by 2020. The agreement assigns the EU Emissions Trading Scheme the central role in the EU's long-term strategy for reducing greenhouse gas emissions.

20% reduction in CO_2 by 2020

With 1990 as the baseline, a 20% reduction results in an emission target of 3,554Mt for total CO_2 emissions across the EU in 2020. Applying the proportion of EU ETS emissions covered in Phase II (52%) to the 2020 target gives an EU ETS allocation of 1,888Mt/yr in 2020 – this is 219Mt/yr below the 2012 allocation. We assume a linear decrease in allocation to reach this level with an average annual allocation of 2,155Mt/yr. This compares to an average annual allocation in Phase II of 2,279Mt/yr – a difference of 124Mt/yr. Note that these figures include the allocation from the Norwegian EU ETS, due to come in 2008, and aviation (all flights arriving and departing from the EU). As these are not covered by the EU's 20% emission reduction target for 2020 we have kept their allocation at 2012 levels.

Supplementarity

To ensure that the EU will reduce emissions domestically rather than import emission reductions from abroad a limit will need to be set on the amount of CDMs/JIs that can be imported into the EU ETS similar to the Phase II import limit. For Phase II the Commission determined this limit by calculating the reduction effort that is required under Kyoto (relative to three different baselines: 1990, 2005, 2010) and then stating that half of this needed to be achieved within the EU ETS sectors and that half can be imported abroad.

Our overall view at the moment is that the EC targets for 2020 remain demanding. Targets such as 20% of electricity consumption to derive from renewables sources by 2020 (which will affect renewable energy capacity build), and for an improvement in energy efficiency of 20% by 2020 seem unrealistic due to the scale and pace of the new build required. Furthermore, the development of new nuclear and Carbon Capture & Sequestration seems unlikely to make a significant contribution until the later stages of the next decade. This potentially places a large burden on the EU ETS to make a sizable proportion of the deficit.

However there is a conundrum here. Whilst the EU ETS could make the necessary CO_2 reductions, it would translate to higher CO_2 prices. This is likely to have a significant impact on the international competitiveness of European industry versus non-EU countries. By increasing the limit on CDMs/JIs the reductions can be made at lower Phase III CO_2 prices. We believe that there is great uncertainty on this issue. We expect this to start in January next year when the *initial review on the framework of the* European Climate Change Programme (ECCP) is expected.

For forecasting purposes, until we have greater clarity we assume that seventy percent of the reduction effort will be met by CDMs/JIs.

Conclusion

We estimate an average clearing price of €25.0/tonne over Phase II

Combining supply and demand balances together we derive our *forecasted price. For our* estimates we assume 170MtCO_2 of banking which harmonises the Phase II and Phase III price. For Phase II we forecast a deficit of 1,436 MtCO_2 over 2008-2012, which in our view is unlikely to be met by *industrial response and* CDM/JI supply (as restricted by estimated supplementary limits in the NAPs). We estimate that 136 MtCO_2 of fuel switching abatement will be needed from the generation sector. On our commodity assumptions this translates to an average clearing price of €25.0/tonne over Phase II.

New CO_2 balance for Phase II

After	2008E	2009E	2010E	2011E	2012E
Net demand (MtCO_2)	261	201	278	307	389
Net demand (MtCO_2)			1436		
Less CDM/JI supply (MtCO_2)			-1301		
Net demand after CDM/JI supply and banking (MtCO_2)			136		
Phase II clearing (€/tonne)					25

Source: Dresdner Kleinwort Research estimates

Capital costs on the rise

A dramatic increase in the price of raw materials, labour cost and delays in power station components all add to the capital costs within our new *entrant assumptions* (CCGT €550/kW to €650/kW, Coal €1000/kW to €1350/kW). Whilst this has a relatively small effect on our new entrant price assumptions (c.£1.5/MWh), it does add further momentum to the power price story.

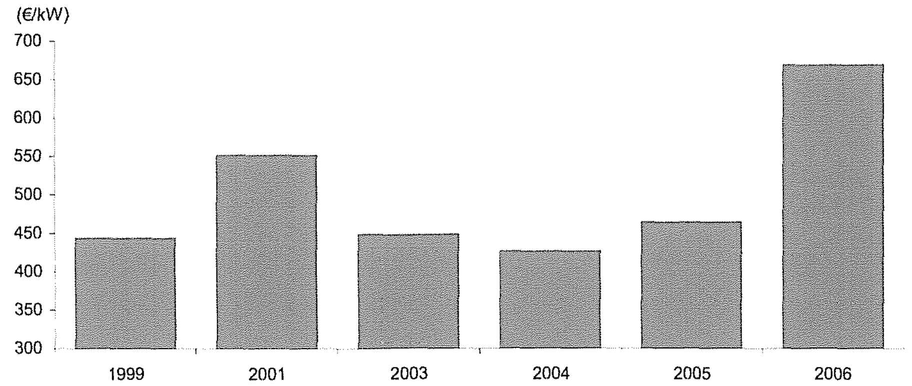
Rising capital costs

The capital cost to build a power station is a small but significant component of the total new-entry cost. However, over the last few years this consideration has increased substantially driven by the following factors:

- Dramatic increases in the price of raw materials driven by high global demand
- A growing backlog of equipment orders from specialist suppliers
- Increased labour costs due to a shortage of skilled staff

When new-build projects are announced, utilities tend to disclose the amount of capacity to be built as well as a forecast for the total amount of capital expenditure required for the development. As the chart below shows, since 2004, the cost of building a CCGT on a €/kW basis has, according to the utilities, steadily increased.

Average new build estimate for CCGT vs. time



Source: Dresdner Kleinwort Research

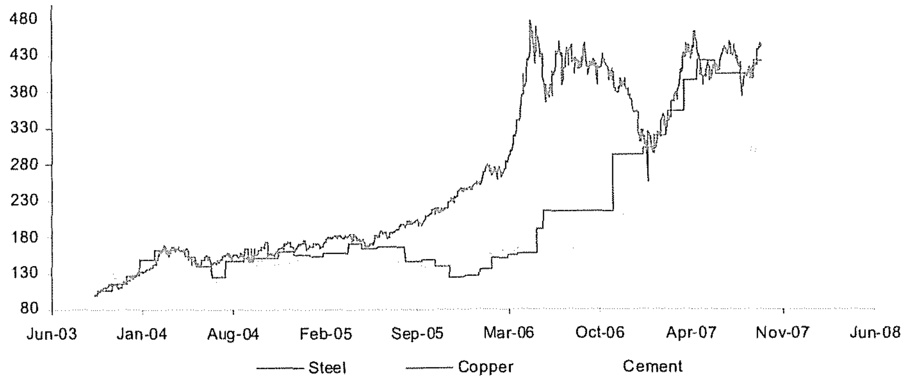
When companies announce new build projects, their estimates will capture the price of materials (including labour) at that point in time. However, the real outturned capex may be substantially higher driven by higher than predicted costs. According to a study by The Brattle Group, of recently completed projects, there is a direct correlation between the commissioning date and the total required investment (ie, a power station completed in 2006 will have cost more than one completed in 2005).

We analyse the components of the construction cost in the section below.

Raw materials exploding in price

Infrastructure projects typically involve large quantities of raw materials, particularly steel, aluminium, copper and cement. As the chart below shows, the price of these commodities has increased dramatically over the last few years driven by the explosive demand growth of developing countries such as China and India.

Commodity price increases



Source: RIMES; Dresdner Kleinwort Research

Steel – a strong driver on inflation of material costs

Of all of these materials, steel is perhaps the most significant as it is used both for fabrication and as a precursor for more specialist materials. Over the last few years, the price of steel has exploded – increasing by five-fold since 2003 driven mainly by China which has become the largest producer and consumer of steel in the world. Given the ubiquitous, non-specific nature of steel we anticipate that costs will remain at high levels for the foreseeable future.

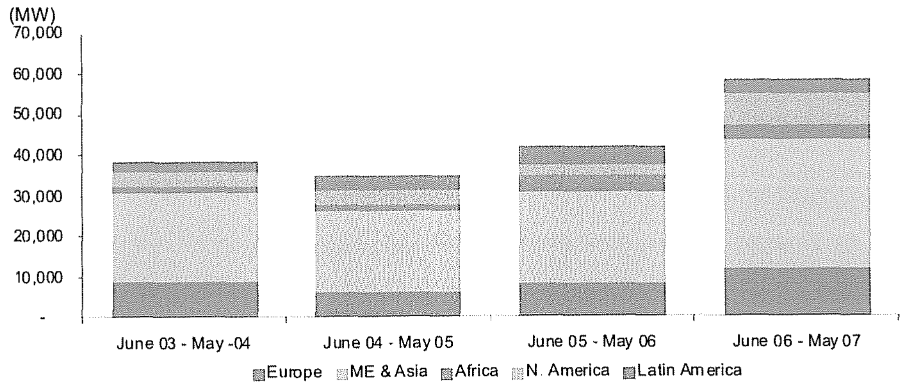
The construction of a power station requires large amounts of cement and stone, which are often combined to make concrete. The price of these two input products has also risen significantly over the last few years for similar reasons to that of steel. In addition, the cost of preparing these materials for the construction industry has increased as a result of energy price increases.

Newly built power stations must be connected to the transmission network in order to supply electricity to the grid. Copper is a key component of this cost as it is used as a conductor in the wires as well as in the transformers that are required to step up the voltage from the power station to that of the transmission network. Secondly, copper is also used in the manufacture of high-quality components in the turbine generator. However, copper is a widely demanded commodity and has a wide range of uses, for example, in circuit boards.

Upwards pressure on price of high-performance equipment

Many of the components of a new power station – for example, the turbine generator – are one-off items that are built to order from a limited number of suppliers. Whilst the cost of the input materials has increased significantly there is also a growing backlog of orders for certain components driven by a significant increase in new build plans in many countries. The chart below shows that most of the turbines currently on order are destined for the Middle East and Asia. Unless utilities have contracts in place with manufacturers, a new-entrant will likely experience a significant delay (compared to historic waiting times) in procuring equipment.

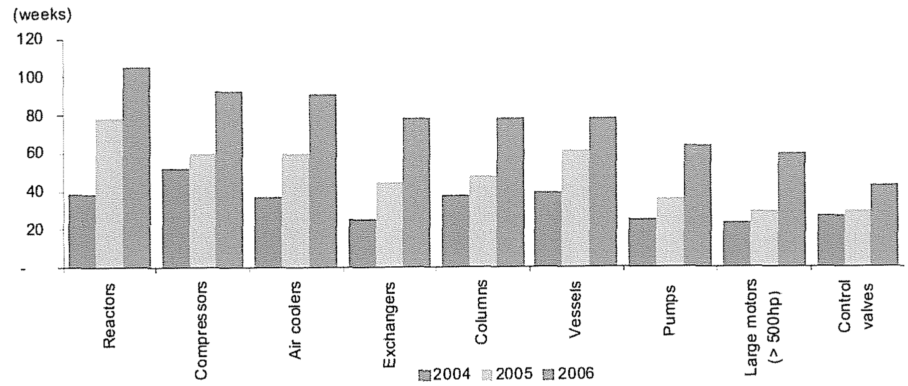
Global CCGT capacity on order



Source: Diesel & Gas Turbine Worldwide

The effect of this backlog is two-fold: a) an increase in price b) a delay to the completion of a construction project (with a knock-on cost impact). Given the high cost of a new entrant for equipment manufacturing and the significant amount of generation capacity required in the next few years, it is unlikely that this backlog will be cleared in the near term. The chart below shows that delivery schedules for all the components of a power station have increased substantially.

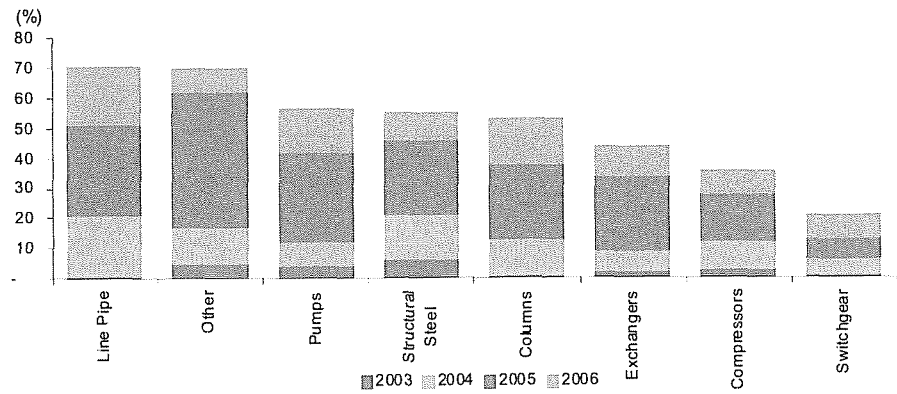
Delivery schedule for power plant components



Source: Bechtel; Dresdner Kleinwort research

According to Bechtel, a US manufacturer, the cost of certain components has increased by more than 70% since 2003 driven by higher input costs and delays in procuring equipment. The chart below shows these price increases since 2003.

Power plant equipment price rises 2003-06

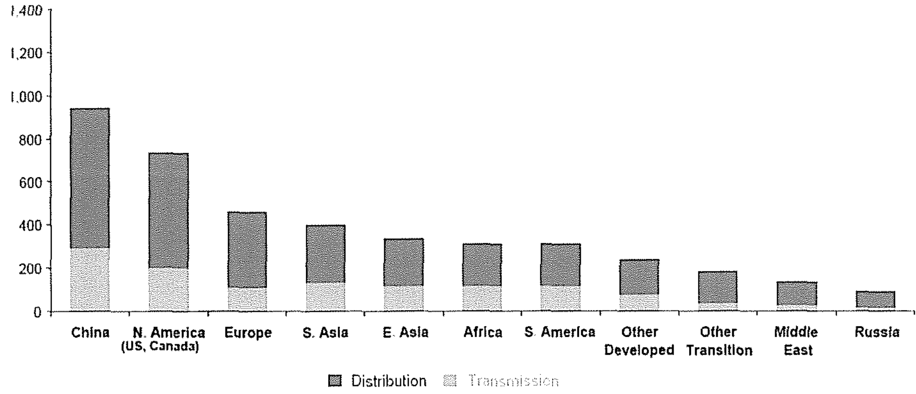


Source: Bechtel

Error

An error occurred while processing this page. See the system log for more details.

Total estimated T&D investments 2003-2030



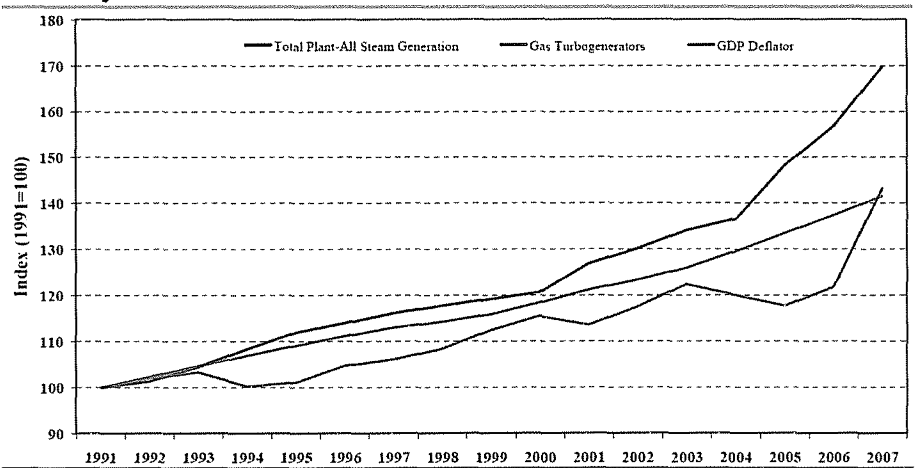
Source: Siemens

Whilst the increase in T&D investments is not of consequence to the generation capital cost *per se*, because the raw inputs are so similar – the boom expected in this section of the supply chain will put additional upwards pressure on the price of commodities which will in turn, affect capital cost.

Construction indices

The effect of rising commodity costs, equipment price rises and labour shortages are all translated into a rising construction cost index, such as "The Handy-Whitman Index." This index (represented graphically below), confirms that generation construction costs have increased above inflation since 1990.

The Handy-Whitman Index



Source: The Brattle Group / EEI

Change in capital cost assumption for new-entrant calculation

We believe that the dramatic rise in the cost of various commodities, labour and equipment is not part of a short-term bubble but instead part of a longer term growth story. We therefore increase our assumptions for the capital cost for a CCGT power station, which is the typical new-entrant and also for pulverised coal power generation to €650/kW and €1350/kW respectively. This increase adds €1.5/MWh to the total costs of a CCGT, €5.6/MWh to the total costs of pulverised coal.

Change to capital cost assumption

(€/kW)	CCGT	Coal-pf
Old assumption	550	1000
New assumption	650	1350

Source: Dresdner Kleinwort Research

Eight years of outperformance

When we downgraded the sector to Neutral at the end of last year (see: *Utilities outlook for 2007*, 19 December 2006), we argued that additional M&A activity was required to push the outperformance beyond the unprecedented seven year bull-run it had already experienced since the bursting of the TMT bubble in Q1 2000.

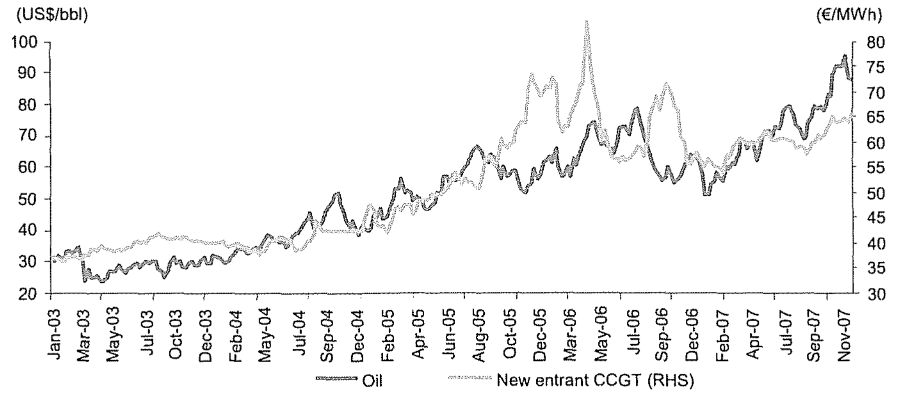
Regulated utilities saw their earnings re-rated...

During the 2000-07 bull-run **regulated** utilities saw their earnings streams **re-rated** as attractive predictable earnings streams became ever more appealing with falling interest rates. In the end the temptation of these predictable, regulated earnings compared to bond yields proved so big that it even encouraged the creation of a completely new type of predator – *infrastructure funds*.

... while competitive utilities became growth stories

The story for **competitive** utilities during the same period was somewhat different. Their performance was not based on a re-rating of existing earnings, but on rapid earnings **growth**, as power prices moved from about €20/MWh (close to short-run marginal cost) to €60/MWh (close to new entry cost). Booming oil, gas and coal prices as well as emission trading ensured that the first major upswing in the long-term European power price cycle proved to be a dramatic one.

New entry cost over time and oil prices



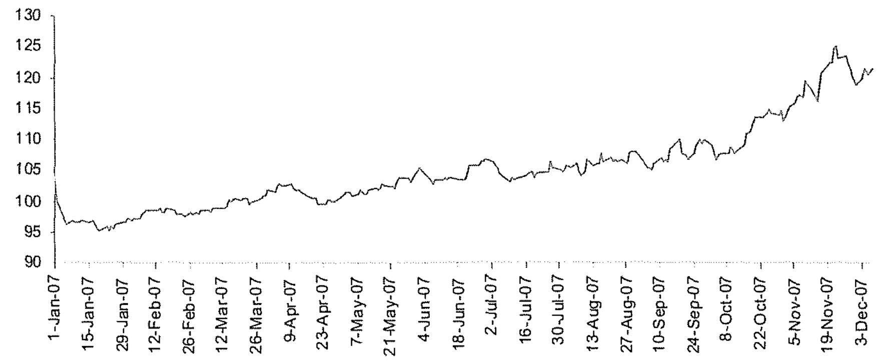
Source: RIMES, Dresdner Kleinwort Research

Sub-prime crisis put the spotlight on the defensive qualities of the sector

Indeed the sector struggled to perform in the first four months of the year as an extremely mild winter led to a weakening of commodity prices. Even by the end of August – already a few weeks into the sub-prime crisis – the sector's outperformance was still only a modest 5%. However, as the sub-prime crisis got worse and the implication of the potential impact on the real economy became clearer, utilities became – once again – a safe haven.

Moreover, coal and oil prices had been ticking up for most of the year but in Q4 2007 this suddenly translated into higher power prices, with the German calendar 2008 breaking through €60/MWh, Nord Pool prices through €54/MWh and UK prices – driven by the spike in oil prices – above €70/MWh.

Sector relative since start 2007



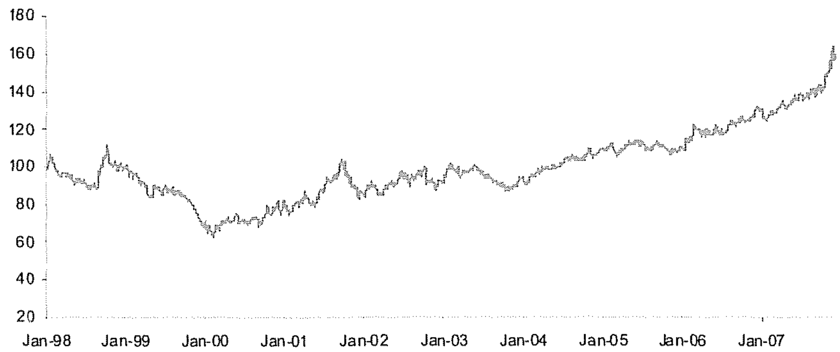
Source: RIMES, Dresdner Kleinwort Research

Sub-prime crisis fails to impact appetite for regulated assets

Moreover, more corporate activity in the UK water/waste sector which saw record premiums to RAB of above 30% being paid or offered (Southern Water, Kelda, Biffa) showed that regulated assets are as attractive as ever and the appetite for them showed no signs of being impacted by the credit crisis.

With the spotlight again on the defensive qualities of the sector by the end of November it had outperformed MSCI Europe by some 25%.

Long-term sector relative



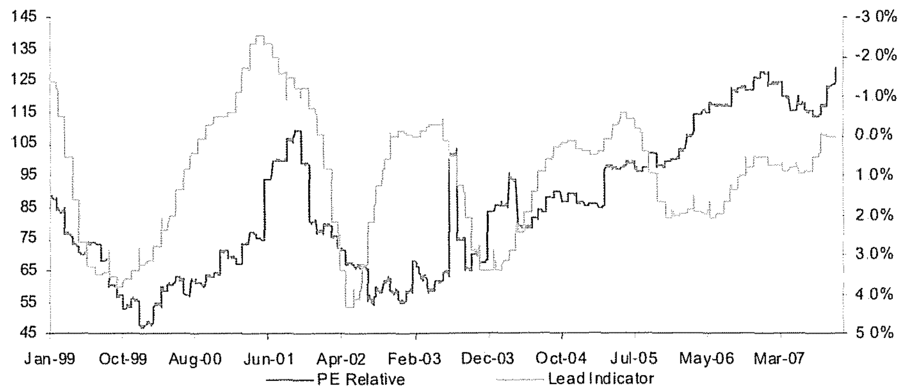
Source: RIMES, Dresdner Kleinwort Research

Oil at $100/bbl – you couldn't make it up

With the sub-prime crisis and relentlessly booming fuel prices the sector added yet another bull year to the seven we have already witnessed since 2000. However, with a P/E relative back-up to historic highs of 130, the dividend yield relative back down to historic lows of 94, coal prices at $115/t and oil having come close to $100/bbl – the question remains as to how long this can continue.

The sector didn't get to where it is today without a change of investor perception of utilities

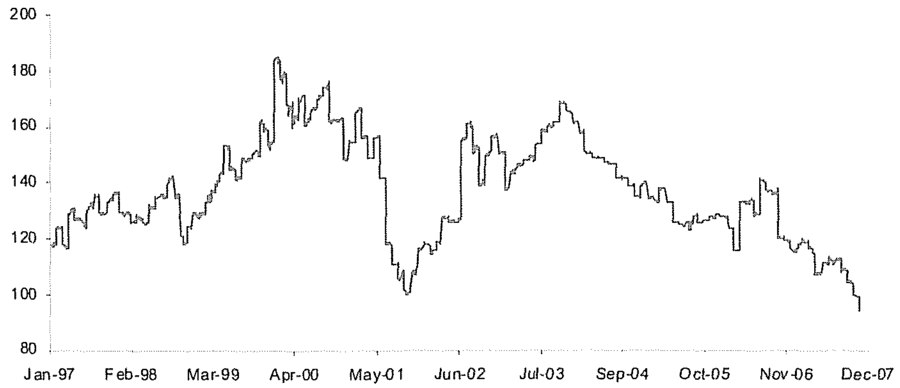
Long-term PE relative



Source: RIMES, Dresdner Kleinwort Research

P/E and yield relative show that earnings quality and growth prospects for the sector have improved dramatically over the last few years

Long-term dividend yield relative

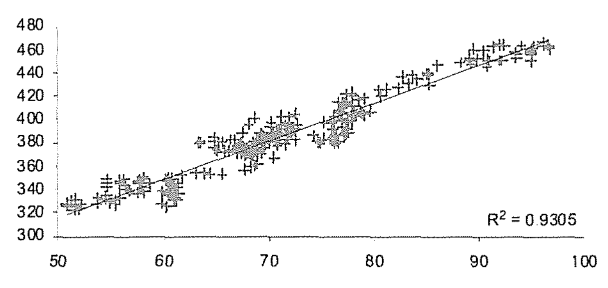


Source: RIMES, Dresdner Kleinwort Research

Oil prices

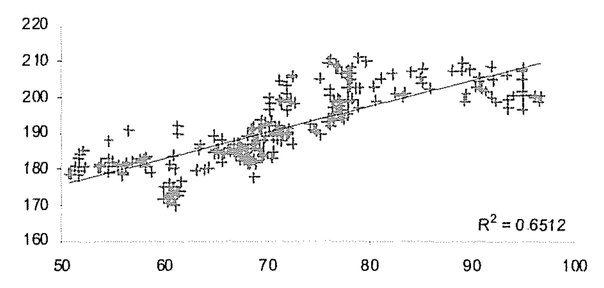
For a sector that is increasingly driven by commodity prices, the direction of oil prices is becoming ever more important and warrants some special attention.

Utilities sector vs oil price



Source: Dresdner Kleinwort Research

Oil sector vs oil price



Source: Dresdner Kleinwort Research

More correlated to oil prices than the oil sector itself

The R^2 for the relationship between the pan-European utility sector and the oil price over 2007 has been 93%. In 2006 it was 72% and in 2005 it was 35%. Interestingly, the sector is now significantly more sensitive to the oil price than the oil sector itself (which has an R^2 of only 65%). The utilities sector is clearly very sensitive to the oil price because:

- It is dominated by companies whose principal business is generating electricity. 74% of the market capitalisation of the utility companies that Dresdner covers are dominated by their generation businesses.

Error

An error occurred while processing this page. See the system log for more details.

2008 – more of the same, but in a more difficult environment

Looking at the main sector drivers behind the outperformance we see the balance still in favour of the utility sector.

Power prices

We have been bulls on the power price since 2003

Since March 2003 we have consistently argued that European power prices will have to rise. At first because the market was slow to realise the impact of emission trading and then because rising fuel- and capital cost kept power prices some €5-10/MWh below new entry cost. For a large part of this period our power price, and therefore earnings, estimates were significantly above the consensus.

Prices could go above €70/MWh, but are unlikely to stay there for long in the near term

We have also argued for some time that long-term power prices should go above €70/MWh, driven by the need to make clean coal technology economically viable (see: *Clean coal – the new black*, June 2007). Given tight reserve margins that will get even tighter due to insufficient investment in new capacity (as opposed to replacement capacity) and steep dispatch curves, even baseload power prices of €80-85/MWh are a real possibility. However, unless new entry cost were to move to this level such spikes will remain just this – spikes – and will see an annual average power price significantly below this level. This also means that it seems unlikely that the utilities' earnings will not be reflecting long-term power prices of €70/MWh or above for some time.

We doubt that many utilities are basing their CCGT investment decisions on the current oil forward curve

Estimates for future power prices are often derived by using current forward curves and feeding those assumptions into a new entrant model. However, this assumes that utilities are actually making investment decisions on the basis of the current forward curve. We doubt that many utilities are currently basing their CCGT investment decisions on $80/bbl oil. As a result we use a discount to the oil forward curve within our power price estimates (using long run prices of $70/bbl real). The following two tables display our new commodity assumptions in real and nominal terms versus our old estimates:

Old commodity assumptions

Real		2008E	2009E	2010E	2011E	2012E
Oil	$/bbl	70.0	67.5	62.5	60.0	60.0
Coal	$/tonne	72.5	70.0	67.5	65.0	65.0
CO_2	€/tonne	22.0	24.0	18.0	18.0	19.5
Continental gas	p/therm	40.6	39.4	36.8	35.5	35.5
UK premium	p/therm	-3.0	-2.0	-1.0	0.0	0.0
UK gas	p/therm	37.6	37.4	35.8	35.5	35.5
UK Elec	£/MWh	37.6	37.9	35.6	35.5	35.8
European Elec	€/MWh	59.9	59.5	55.1	53.9	54.4
Nominal		2008	2009	2010	2011	2012
Oil	$/bbl	71.8	70.9	67.3	66.2	67.9
Coal	$/tonne	74.3	73.5	72.7	71.7	73.5
CO_2	€/tonne	22.6	25.2	19.4	19.9	22.1
Continental gas	p/therm	41.6	41.3	39.6	39.2	40.2
UK premium	p/therm	-3.1	-2.1	-1.1	0.0	0.0
UK gas	p/therm	38.6	39.2	38.6	39.2	40.2
UK Elec	£/MWh	38.6	39.9	38.4	39.2	40.5
European Elec	€/MWh	61.4	62.5	59.3	59.5	61.6

Source: Dresdner Kleinwort Research estimates

New commodity assumptions

Real		2008E	2009E	2010E	2011E	2012E
Oil	$/bbl	80	75	72 5	70	70
Coal	$/tonne	100	90	85	80	70
CO_2	€/tonne	25	25	25	25	25
Continental gas	p/therm	43 5	41.1	39 8	38 6	38.6
UK premium	p/therm	-3.0	-2 0	-1 0	0.0	0.0
UK gas	p/therm	40 5	39.1	38 8	38 6	38.6
UK Elec	£/MWh	41 4	40 5	40 9	40 8	40 8
European Elec Gas	€/MWh	61.9	59.8	59 5	59.2	59 2

Nominal		2008	2009	2010	2011	2012
Oil	$/bbl	80	76 9	76 2	75.4	77.3
Coal	$/tonne	100	92.3	89 3	86.2	77 3
CO_2	€/tonne	25	25 6	26 3	26 9	27 6
Continental gas	p/therm	43 5	42.1	41.9	41 6	42 6
UK premium	p/therm	-3.0	-2 1	-1.1	0 0	0.0
UK gas	p/therm	40.5	40.0	40 8	41.6	42 6
UK Elec	£/MWh	41.4	41.5	43.0	43.9	45.0
European Elec	€/MWh	61.9	61.3	62.5	63.7	65.3

Source: Dresdner Kleinwort Research estimates

Earnings upgrades to generators will be harder to come by in the future

As the tables show, these take into account our view of higher CO_2 prices, coal prices and capital costs detailed in previous sections. Using these estimates, we forecast new entry power price costs at **€62/MWh**. This compares to some estimates already reflecting €70/MWh. In our view, €70/MWh is possible if the forward oil curve stays at $80/bbl, but it does indicate that earnings upgrades for the generators are going to be harder to come by in the future unless the oil price keeps rising.

M&A

Rising political borders are slowing the pace of M&A, but not stopping it entirely

When E.ON bid for Endesa it was generally seen as the starting shot for the next big consolidation wave in the sector, as hostile cross-border bids now seemed a real possibility. However, the eventual outcome of the Endesa saga and the defensive Suez-GDF merger showed that this optimism was perhaps a little pre-mature. There is growing evidence that political borders are rising again, with the always notable exception of the UK, where infrastructure funds continue to snatch-up the last remaining regulated utilities at premiums to RAB that suggest the credit crisis has little perceived impact for companies offering predictable returns.

Recent M&A transactions in the UK

Date	Acquiring company	Target company	Premium to RAB
Oct-06	Macquarie	Thames Water	27
Dec-06	SE Water	Mid Kent Water	25
Oct-07	JP Morgan consortium	Southern Water	31
Oct-07	Alinda	South Staffordshire	45
Nov-07	JP Morgan consortum	Norweb	45
Nov-07	CKI / GIC / HSBC	Kelda	29

Source: Dresdner Kleinwort Research

Forget (some) of the usual suspects

The usual suspects are also becoming less suspect. We believe that E.ON has already spent most of its discretionary capex and is likely to hit its targeted balance sheet structure in 2008, so buying the Enel/Acciona assets in Italy, Spain and France could well be the last major transaction for some time. Endesa has pretty much sorted out Enel's balance sheet and EdF CEO Gadonneix has stated that it does not see itself making hostile deals. Which is just as well, given that 84.8% of EDF's equity is still controlled by the French state. Of the usual suspects only RWE has got enough firepower (€19-24bn post AWW) together with an ownership structure that would allow bigger hostile deals, although these days RWE is more often mentioned as a potential target rather than as a predator.

However, despite the usual suspects retiring to the bench there is still the prospect for plenty of action to underpin valuations and keep the bears on guard. In particular we see potential for M&A activity in the following areas:

Known knowns:

- Endesa Italy/SNET/Viesgo/1.9GW of Spanish generation capacity. The agreement between E.ON and Enel/Acciona from 3 April 2007 provides for the above assets to be acquired by E.ON for an EV "in excess of €10bn". Enel/Acciona did not take effective control of Endesa until October 2007, so the valuation process could not start before November. The transaction should close in H1 2008. We assume a transaction value of €11.65bn.

- Suez Environment. Suez will IPO the environment business (water, waste) "at the same time as the merger", which could be as early as Q1 2008. Valuations for the division vary between €18-22bn.

Unknown knowns:

- Gas Natural/Repsol/Union Fenosa? There appears to be relentless potential for M&A activity in the Spanish energy sector. Despite the Spanish construction companies (ACS, Acciona) positioning themselves in the utility sector and one unwanted foreigner being replaced with a slightly more wanted one in the case of Endesa – there remains plenty of unfinished business.

- With all the various twists and turns in the Endesa saga it is easy to forget that the story was initiated by Gas Natural and the Catalan desire to create "a national champion", based in Barcelona, of course. You can't blame Gas Natural for not having tried, but after attempts at Iberdrola and Endesa it is still looking for critical mass – something that Repsol is lacking as well. Recent statements by Repsol CEO Brufau that the company is looking to sell its LatAm assets (YPF) have lead to speculation that any cash coming from such a transaction could be used to finally drive domestic consolidation forward, something that could involve – apart from Repsol and GasNat – Union Fenosa.

- Pennon. The temptation for a break-up bid on Pennon might eventually become too large, especially if Biffa is sold at an attractive price that would imply a higher valuation for Pennon's Viridor Waste. So far Biffa's management already rejected two approaches, saying that they still "materially undervalue the business and prospects of Biffa".

- Northumbrian. With an EV of only €5.4bn and a premium to RAB of only 16% it certainly is "bite-size" and promises significant upside a bid were to come in anywhere near the exit multiples seen on other UK water deals. The 26% holding by the Ontario Teachers Fund does not seem like an obstacle because they could be invited to join a consortium bid (which seems how most recent deals have been organised).

- Russia. Privatisations continue with OGK-1&6 as well as TGK-2,6,7,10,11 & 13 all due to be sold in Q1 2008 (mainly February). In particular TGK-10 (Fortum, GDF and Rosneft have already expressed some interest) and OGK-1 are attractive assets which should see a lot of interest, in our view.

It's all relative...

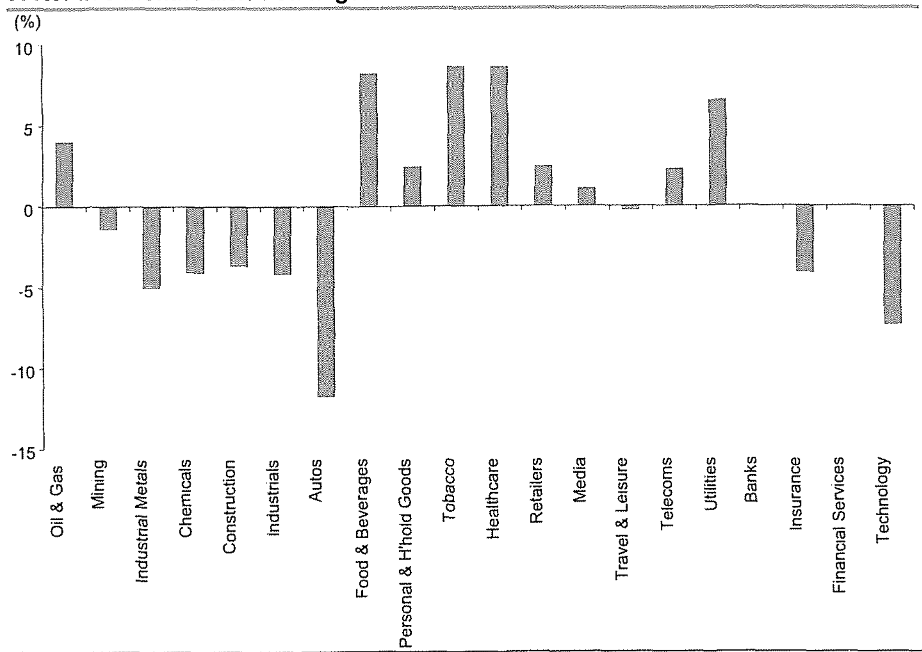
Upgrade to Overweight from Neutral

Power prices that are set to rise further, perhaps even see prolonged spikes, achieved power prices that have a long way to go merely to catch up with current market prices and plenty of M&A activity all point towards another good year for the utility sector.

Safe regulated- and quasi-regulated earnings from the generators (as achieved prices catch-up with market prices) do look very attractive, especially compared with the very uncertain earnings outlook for the market overall.

Our strategists argue that European equities fell in five out of six Fed cutting cycles in the last 20 years, as the Fed does not cut for free (see: *European Equity Strategy ...and portfolio construction*, 29 November 2007). The shift from a Goldilocks outlook, which allows risks to be taken and the cycle to be ignored, is not yet complete. Risk has been rediscovered but the assumption is still that 2% GDP growth is available and that double-digit earnings growth is the divine right of equities.

European winners & losers from the Fed cutting cycle: average relative performance by sector in 6-months after Fed target rates are cut[1]



[1]based on previous 6 rate cycles since 1987 where Fed target rate fell by 75bps or more over 3 or more meetings
Source: Dresdner Kleinwort Research

Historically, US recessions have been associated with a 10% reduction in lending and consensus earnings that are 30% too high. The late 1980s – which may be a more appropriate template than the assumption of a repeat of 1998 – saw European and UK P/E multiples fall to 10.5x in aggregate, some 20% lower than today's levels.

Looking at the last six Fed cutting cycles since 1987 shows that European equities have ended down six months after the Fed has started to cut rates and that the best performing sectors were Healthcare, Tobacco, Food & Beverages and, of course, utilities.

With the earnings outlook for the generators in the sector continuing to look bright, overall earnings set to hold up well in the face of general market earnings downgrades and the prospect of further M&A activity, we believe that utilities will outperform – yet again – in 2008 and therefore upgrade the sector to overweight.

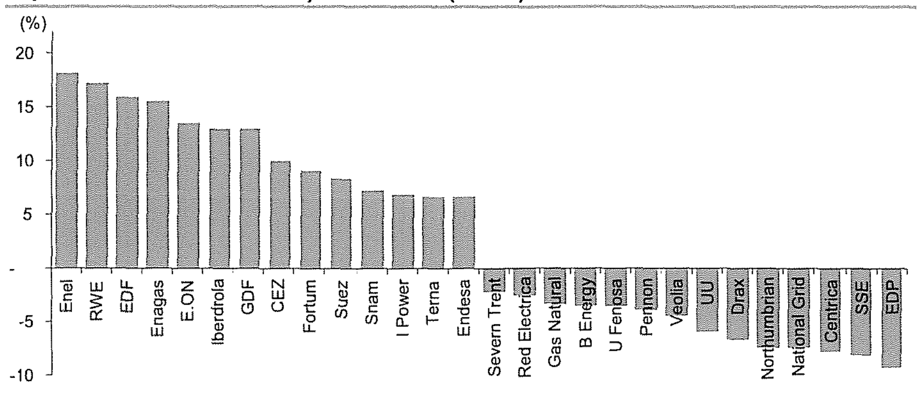
A summary of our target price and rating changes can be found below.

Price target and recommendations changes

	Share price	Rec.	From	Price target	From	DPS (next 12m)	Total return (next 12m) (%)
Czech Republic (CZK)							
CEZ	1,391	Add	Initiate	1,500	NA	29.7	10.0
Finland (€)							
Fortum	29.3	Add	from Buy	31.0	27.0	0.90	9.1
France (€)							
EDF	81.2	Buy	Unchanged	92.0	NA	2.1	15.9
Gaz de France	39.4	Buy	Unchanged	43.3	39.5	1.22	13.0
Suez	45.6	Buy	Unchanged	48.1	44.5	1.32	8.3
Veolia Environment	64.0	Hold	Unchanged	60.0	60.0	1.20	-4.4
Germany (€)							
E.ON	142.9	Buy	Unchanged	158.0	152.0	4.20	13.5
RWE	94.8	Buy	Unchanged	108.0	105.0	3.10	17.2
Italy (€)							
Enel	8.32	Buy	from Add	9.30	8.20	0.49	17.7
Snam Rete Gas	4.44	Add	from Hold	4.55	4.55	0.21	7.3
Terna	2.72	Add	Unchanged	2.75	2.8	0.15	6.7
Portugal (€)							
EDP	4.65	Hold	Unchanged	4.1	4.1	0.125	-9.1
Spain (€)							
Enagas	20.9	Buy	Unchanged	23.5	23.5	0.61	15.6
Endesa	37.9	Hold	Unchanged	38.8	38.8	1.63	6.7
Gas Natural	43.1	Hold	from Reduce	40.5	40.5	1.14	-3.3
Iberdrola	10.9	Hold	Unchanged	11.0	11.0	1.29	13.0
Red Electrica	42.2	Buy	Unchanged	40.0	40.0	1.07	-2.6
Union Fenosa	45.5	Hold	Unchanged	42.5	42.5	1.46	-3.4
UK Energy (p)							
British Energy	521	Hold	from Sell	490.0	410.0	13.6	-3.4
Centrica	367	Sell	Unchanged	325.0	315.0	13.7	-7.7
Drax	680	Hold	Unchanged	620.0	620.0	14.7	-6.6
International Power	446	Add	Unchanged	465.0	450.0	11.3	6.9
National Grid	838	Add	Unchanged	740.0	740.0	36.0	-7.3
Scottish & Southern Energy	1,617	Reduce	from Hold	1,420.0	1,360.0	65.0	-8.2
UK Water (p)							
Northumbrian	345	Add	Unchanged	320.0	320.0	12.0	-7.2
Pennon	656	Add	Unchanged	630.0	630.0	19.4	-3.9
Severn Trent	1,524	Hold	Unchanged	1,490.0	1,490.0	63.7	-2.2
United Utilities	769	Hold	Unchanged	725.0	725.0	46.6	-5.8

Source: Dresdner Kleinwort Research

Expected total return of European utilities (2008E)



Source: Dresdner Kleinwort Research

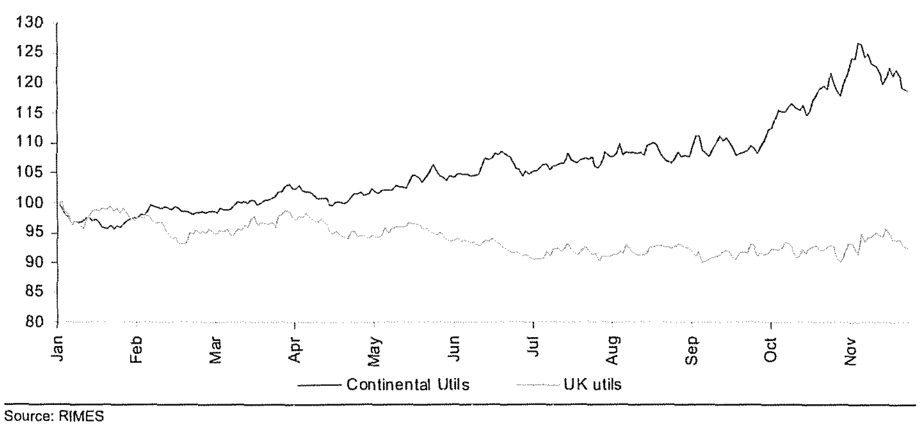
Most attractive for 2008

We still see good value in the power price plays, which we have favoured for some time, such as EDF, E.ON and RWE. These are now joined by Enel (upside from Endesa integration, continued high Italian power prices and favourable regulation on distribution) and Enagas (upside from regulatory changes, visibility on capex programme). We estimate that these stocks offer total potential returns of about 15-20% for 2008, which should compare well to market returns.

Least attractive for 2008

Due to regulated earnings holding up well and various themes working well for the sector (power prices, renewables, M&A), we do not expect many utilities to deliver negative total returns in 2008. However, as we did for 2007, we expect the UK utilities sector to underperform the continental utilities sector.

Relative performance of Continental Utilities versus UK over 2007 to date



Source: RIMES

This page has been left blank intentionally

Dresdner Kleinwort

Company section

E.ON

RWE

EdF

Enel

Enagas

This page has been left blank intentionally

Dresdner Kleinwort

Utilities sector outlook 2008

13 December 2007

E.ON

Oh come all ye faithful

Buy

Unchanged

Current	€142.9
Target	**€158.0**
Previous	€152 0

Current price equivalent
US$209.9

Market cap
€98,908m
US$145,282m

52-week high/low
€143.7/€95.8

Price performance	1M	3M	12M
Price (€)	135 0	123 3	101 6
Absolute (%)	5.9	15.9	40 7
Rel market (%)	3 7	14 0	34 8
Rel sector (%)	3.4	2.3	16.6

EPS change	1M	3M	12M
EPS FY1 (%)	1 0	0 7	-13 7
IBES EPS (%)	1 6	2 2	7 9
Sector EPS (%)	-0 3	-1 5	2 9
Market EPS (%)	-1.1	-2.1	0.6

Source: DKIB Research, Thomson IBES

Reuters	Bloomberg
EONG.F	EOA GR Equity

Derivation of price target

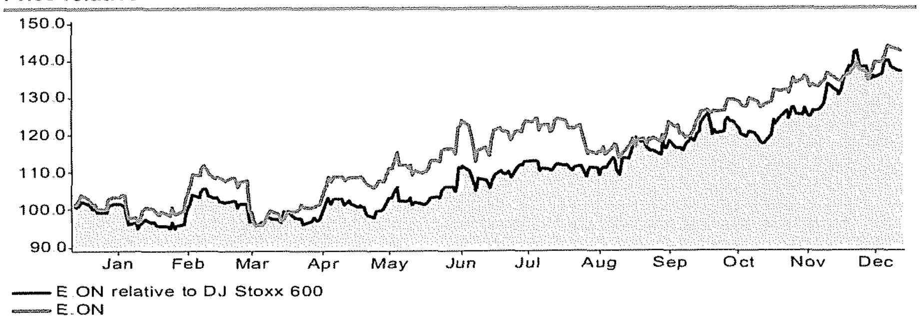
	€ bn	Valuation basis
Central Europe	66.1	DCF
Endesa Europe	14 8	8 3x 2009 EBITDA
Pan-European Gas	30.3	8 3x 2009 EBITDA
UK	21 1	8 3x 2009 EBITDA
Nordic	11 0	8 3x 2009 EBITDA
OGK-4	5 9	Inv cap
E ON Renew	6 3	Inv cap
US-Midwest	4 3	8.3x 2009 EBITDA
Other / Consol	(3 2)	8 3x 2009 EBITDA
Total EV	156 5	
Net debt	(29 7)	
LT provisions	(28 5)	
Net min. & oth.	(7 5)	
Fin assets	27 2	
Adjustments	(15 4)	
Equity value	102.5	
Shares (m)	647 4	
Eq. val p/sh(€)	158.3	

Source: DKIB Research estimates

Despite having spent most of its discretionary capex, reinvestment risk is slow to disappear, as can be seen by the big discounts to the sector at which E.ON continues to trade. E.ON does not yet get full credit for the value of its Gazprom stake nor its growth profile or earnings quality. We believe that E.ON's defensive earnings will be re-rated in 2008.

- **Current market perception:** For years the market has punished E.ON with a big discount for re-investment risk, despite a track record that includes perhaps some of the best deals ever done in the sector (Ruhrgas as well as most disposals, but especially VIAG Intercom). Since the presentation on its balance sheet structure in May this year some of the scepticism has disappeared, however, the market appears to be a little reluctant to completely get rid of the discount just yet.
- **Dresdner Kleinwort view:** Although E.ON only announced its €60bn capex programme for 2007-10 in May this year, it has already spent most of the discretionary capex in the plan, which means that E.ON is about to enter a period of consolidation. Together with regulated and quasi-regulated earnings (avg achieved prices catching up with current market prices) E.ON, if anything, deserves to trade at a premium to the sector in our view.
- **Risk to Dresdner Kleinwort view:** There could be a case of 'old habits dying hard', but given E.ON's track record on acquisitions – which in our view is certainly better than perception – we are not that concerned by that (unlikely) scenario.
- **Upcoming events:** 6 Mar 2008: FY2007 results; 30 Apr 2008: AGM; 2 May 2008: ex-div, 14 May 2008: Q1 2008 results

Price relative



Source: RIMES

Year to end Dec	EBITDA €m	Rec EPS €	P/E x	Adj. P/E x	DPS €	Yield %	Net debt/ EBITDA x	FCF Yield %	EV/EBITDA x
2006	11,789	6 65	21 7	16 8	3 35	2 3	1 5	3 1	9 4
2007E	12,877	7 61	19 0	12 9	4 20	2 9	2 0	3.3	8 8
2008E	15,419	9 95	14 5	10 8	5.50	3.8	3 0	1 4	8 9
2009E	17,637	11 88	12 2	9 5	6.50	4 5	2 7	4.9	7.9

Source: Company data, Dresdner Kleinwort Research estimates

Research Analysts
Lueder Schumacher
+44 (0)20 7475 2491
lueder schumacher@dkib com

Please refer to the Disclosure Appendix for all relevant disclosures and our disclaimer.

E.ON – summary information (Endesa Europe and selective Spanish assets fully consolidated from Jul 2008)

Assumption:
E.ON will consolidate Endesa Europe and selected Spanish assets - combined EV of €11.65bn - from 1 July 2008

E.ON Outlook, Nov 2007:
2007 EBIT + "5-10%"
E.ON Outlook, May 2007:
2007 EBIT to "surpass" '06

E.ON target:
10% compound EBIT growth to 2010 **("10 by 10")**
=> 2010 EBIT of €12.4bn

Low tax rate due to:
higher tax-exempt earnings
€1,279m from first time recognition of corporate tax credits
€1.2bn from deferred tax benefits as a result of losses from marking-to-market of energy derivatives

E.ON Outlook, Nov 2007:
Improvement in adj. NI "comparable to rise in adj. EBIT" => + "5-10%"

Dividend policy:
- payout ratio of 50-60%
- avg growth of 10-20%

E.ON Nov 2007:
9m Cash from operating operations +61% to €7,223m

Fixed asset investments 2007-09: **€19.7bn** (vs Dec '06 investment plan of **€22.4bn**)

E.ON Nov 2007:
9m Free cash flow +63% to €3,128m

E.ON Nov 2007: Net debt of €1,291m, but rest of '07 buy-back, OGK-4 and renewables acquisitions still to come

E.ON could achieve targeted net debt/EBITDA of 3-3.5x already in 2008 (target rating of single flat A/A2)

Year to end December (€m)	2006	2007E	2008E	2009E	2010E	2011E	2012E	(%)	(%)
Sales	67,759	74,409	83,398	89,653	93,535	97,025	100,441		
Total income	72,429	79,314	88,279	94,712	98,746	102,394	105,936		
- Operating costs	51,560	56,903	62,849	66,564	68,606	70,370	72,479		
- Other	9,080	9,534	10,011	10,511	11,037	11,589	12,168		
EBITDA	11,789	12 877	15 419	17 637	19 104	20,435	21,289		
Depreciation	3,433	3,395	4,143	4,609	4,736	4,904	5,046	2007 - 12	2006 - 10
EBIT (IFRS)	8,356	9,482	11,276	13,028	14,368	15,530	16,243	11.4	14.5
% change		13.5	18.9	15.5	10.3	8.1	4.6	Target:	10
Net financial	(1,287)	(981)	(1,568)	(1,806)	(1,670)	(1,531)	(1,272)		
Extraordinaries	(1,936)	1,270	0	0	0	0	0		
Profit Before Tax	5,133	9 771	9 708	11,222	12,698	14,000	14 971		
Tax	323	(2,704)	(2,797)	(3,267)	(3,724)	(4,124)	(4,417)		
Profit After Tax	5,456	7,067	6,912	7,955	8,975	9 876	10 553		
Minorities	(526)	(610)	(502)	(521)	(547)	(570)	(595)		
Net Income (continuing oper.)	4,930	6 457	6 409	7,435	8,428	9 306	9 958		
Discontinued operations	127	(94)	0	0	0	0	0		
Changes in accounting principle	0	0	0	0	0	0	0		
Net Income	5,057	6,363	6,409	7,435	8,428	9,306	9,958		
Adjustment	(544)	(1,535)	(213)	(181)	(154)	(131)	(111)		
Recurring Net Income	4,386	4 922	6 197	7 254	8 274	9,175	9,847		
Shares	659.15	646.38	620.83	608.06	608.06	608.06	608.06		
EPS (€) - Stated	7.67	9.84	10.32	12.23	13.86	15.30	16.38	2007 - 12	
EPS (€) - Recurring	6.65	7.61	9.98	11.93	13.61	15.09	16.19	16.3	
% change		14.4	31.1	19.5	14.1	10.9	7.3	2007 - 12	
DPS (€) (Ordinary dividend)	3.35	4.20	5.50	6.60	7.50	8.30	8.90	16.2	
Payout (%)	50.3	55.2	55.1	55.3	55.1	55.0	55.0	2007 - 12	
EPS(€) -Recur-pre Endesa ass.		7.61	9.47	10.76	12.29	13.65	14.62	13.9	
% enhancement			5.4	10.9	10.7	10.5	10.8		
Summary cash flow								2007 - 12	
Operating Cash Flow	7,194	8,880	10,597	12,769	13,945	14,797	15,447	11.7	
CFPS	10.91	13.74	17.07	21.00	22.93	24.33	25.40		
Core Capex	(4,083)	(5,586)	(9,223)	(7,840)	(6,647)	(6,498)	(5,020)		
Financial capex	(1,078)	(11,403)	(18,800)	(1,600)	(900)	(900)	0		
Disposals	2,023	300	0	0	0	0	0		
Disposals (equity acc. assets)	3,651	684	0	0	0	0	0		
Dividend (previous year)	(1,813)	(2,208)	(2,661)	(3,344)	(4,013)	(4,560)	(5,047)		
Free cash flow post divs & inv.	5,894	(9,333)	(20,087)	(15)	2,385	2,838	5,381	2007 - 12	
Free cash flow pre dividends	3,111	3,293	1,374	4,929	7,298	8,299	10,427	25.9	
Free cash flow yield (%)	3.3	3.5	1.4	5.2	7.7	8.8	11.0		
Summary balance sheet									
Fixed Assets	96,344	109,638	133,518	138,348	141,159	143,653	143,627		
Current Assets	30,888	31,608	33,980	34,975	38,170	42,034	48,673		
Total Assets	127,232	141,246	167,498	173,324	179,329	185 687	192 300		
Shareholders' Funds	52,762	57,601	61,349	65,439	69,854	74,600	79,511		
Current Liabilities	27,196	37,573	58,605	59,359	59,934	60,494	61,103		
Provisions	24,175	22,972	24,446	25,426	26,442	27,495	28,587		
Long-term liabilities	23,099	23,099	23,099	23,099	23,099	23,099	23,099		
Equity & Liabilities	127,232	141 246	167 498	173 324	179,329	185,687	192,300		
BVPS	72.59	81.51	90.90	99.53	106.79	114.60	122.68		
Stated net debt / (cash)	268	9,601	29,688	29,704	27,319	24,481	19,100		
Pension/nuclear provisions	17,531	16,150	17,131	17,600	18,086	18,589	19,111		
Rating net debt / (cash)	17,799	25,751	46,819	47,304	45,405	43,070	38,211		
Net debt / EBITDA (x)	1.5	2.0	3.0	2.7	2.4	2.1	1.8		
Net Gear. (stated net debt) (%)	0.6	18.2	52.6	49.1	42.1	35.1	25.6		

Source: Company data, Dresdner Kleinwort Research estimates

Dresdner Kleinwort

Utilities sector outlook 2008

13 December 2007

Buy

Unchanged

Current	€95.2
Target	**€108.0**
Previous	€105 0

Current price equivalent
US$139.8

ADR
US$139.8

Market cap
€52,989m
US$77,813m

52-week high/low
€97.7/€75.2

Price performance	1M	3M	12M
Price (€)	94 4	80 7	87.9
Absolute (%)	0 8	17 9	8 2
Rel market (%)	-1 3	15 8	3 6
Rel sector (%)	-1.7	3.9	-10.4
EPS change	**1M**	**3M**	**12M**
EPS FY1 (%)	8 8	7 9	-14 6
IBES EPS (%)	-0 9	1 2	3 2
Sector EPS (%)	-0 3	-1 5	2 9
Market EPS (%)	-1.1	-2.1	0.6

Source: DKIB Research, Thomson IBES

Reuters	Bloomberg
RWEG.F	RWE GR Equity

Derivation of price target

	€ bn	Valuation basis	
RWE Power	42 7	DCF	
RWE Energy	26 6	8 3x	2007 EBITDA
RWE npower	10 8	8 3x	2007 EBITDA
Total core bus.	80 1		
Other	(0 4)		
LT fin assets	(0 6)		
Total EV	79 1		
Net debt	1 2		
LT provisions	(20 2)		
Net min & others	(0 7)		
Equity value	59 5		
Ordinary sh (m)	523 4		
Pref shares (m)	39 0		
Eq. Val p/sh. (€)	107 7		
Discount	0 0		
Price target (€)	107.7		

Source: DKIB Research estimates

Research Analysts
Lueder Schumacher
+44 (0)20 7475 2491
lueder schumacher@dkib com

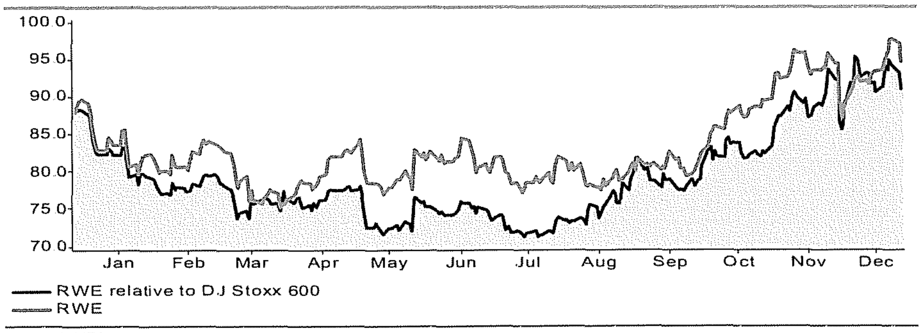
RWE

Let it snow, let it snow, let it snow

The initial disappointment over the delayed American Water Works was quickly forgotten. We continue to believe that the IPO will go ahead in 2008, leading to a yield of about 5% from 2008 onwards. New CEO Grossmann is likely to reassure investors on re-investment risk, leaving the power price story to work its cause.

- **Current market perception:** CO_2 cost exposure and concerns over the change in management has cost RWE dearly in H1 2008, underperforming the sector by 20%. Phase II CO_2 exposure is now in the price and some unease over the new management has been removed. However, some doubts remain, as the share price reaction to the delay in the AWW IPO shows.
- **Dresdner Kleinwort view:** We believe that the introduction of new CEO Grossmann will go well and that RWE will IPO at least 51% of AWW in 2008, probably in H2. This could lead to 2008 DPS of €5.30 – more than 30% ahead of current consensus estimates. A solid 5% yield protects the downside, while RWE's quasi-regulated earnings (avg achieved prices catching up with current market prices) means that earnings for the next two years are unlikely to be revised downward – irrespective of recession scenarios.
- **Risk to Dresdner Kleinwort view:** If Grossmann were to be perceived as an empire-builder, particularly away from RWE's core energy business, that would lead to a dramatic de-rating. However, we see little evidence to support that view. CO_2 cost exposure in Phase III could also become an issue, despite the fact that a final solution is some years away.
- **Upcoming events:** 23 Jan 2008: EC to comment on Phase III CO_2 allocations; 22 Feb 2008: FY2007 results and Grossmann strategy presentation, 17 Apr 2008: AGM; 18 Apr 2008: ex-div; 15 May 2008: Q1 2008 results.

Price relative



Source: RIMES

Year to end Dec	EBITDA €m	Rec EPS €	P/E x	DPS €	Yield %	Net debt/ EBITDA x	FCF Yield %	EV/EBITDA x
2006	7,861	4 38	21 7	3 50	3 7	(0 6)	4 3	9 9
2007E	8,911	5 69	16 7	3 10	3 3	0 3	3 2	8 8
2008E	9,440	7 07	13 5	5 30	5 6	0 0	2 1	8 0
2009E	9,605	7 63	12 5	4 60	4 8	(0 1)	2 7	7 7

Source: Company data, Dresdner Kleinwort Research estimates

Please refer to the Disclosure Appendix for all relevant disclosures and our disclaimer.

RWE - summary information

Year to end December (€m)	2005	2006	2007E	2008E	2009E	2010E	2011E
Sales	39,487	44,256	44,118	45,794	45,327	46,083	46,600
Total income	40,604	44,715	44,572	46,136	45,583	46,270	46,726
- Operating costs	33,509	36,854	35,662	36,696	35,977	36,038	36,186
EBITDA	7,095	7,861	8.911	9 440	9.605	10 232	10 540
(%)		10.8	13.4	5.9	1.7	6.5	3.0
Operating result	5,371	6,106	7,191	7,689	8,100	8,707	8,995
% change		13.7	17.8	6.9	5.4	7.5	3.3
Non-operating result	(634)	(414)	(142)	(327)	(327)	(327)	(327)
Financial result	(1,581)	(2,035)	(1,316)	(1,513)	(1,452)	(1,509)	(1,565)
Profit Before Tax	3,156	3,657	5.733	5 849	6.321	6 871	7 103
Tax	(1,086)	(984)	(2,169)	(1,782)	(1,933)	(2,109)	(2,183)
Profit After Tax	2,070	2,673	3,564	4,067	4,388	4,762	4,920
Minorities	(224)	(166)	(191)	(200)	(210)	(221)	(232)
Discontinued operations	385	1,338	0	0	138	0	0
Net Income	2,231	3,845	3,373	3,867	4,316	4,541	4,688
% change		72.4	(12.3)	14.6	11.6	5.2	3.2
Adjustment	411	(41)	(175)	111	111	111	111
Recurring Net Income	2,257	2,466	3 198	3.978	4 288	4.652	4.799
Average number of shares	562.38	562.37	562.37	562 37	562.37	562 37	562.37
EPS (€) - Stated	3.97	6.84	6.00	6.88	7.67	8.07	8.34
EPS (€) - Recurring	4.01	4.38	5.69	7.07	7.63	8.27	8.53
		9.3%	29.7%	24.4%	7.8%	8.5%	3.2%
DPS (€) (Ordinary dividend)	1.75	3.50	3.10	5.30	4.60	5.00	5.10
Payout (%)	43.6	79.8	54 5	74 9	60 3	60 4	59 8
Summary cash flow (€m)							
Reported operating Cash Flow	5,304	6,783	6,493	6,742	6,885	7,058	7,324
Core capex	(3,667)	(4,494)	(4,794)	(5,608)	(5,420)	(5,424)	(5,386)
Disposals	635	7,532	400	3,295	3,166	0	0
Free Cash Flow pre acquisitions	2,272	9,821	2,099	4 429	4,631	1.635	1 938
Financial Capex	(476)	(234)	(70)	(70)	0	0	0
Dividend	(844)	(984)	(1,968)	(1,743)	(2,981)	(2,587)	(2,812)
Share buy-back							
Free Cash Flow	952	8,603	61	2.616	1 650	(952)	(874)
Stated free cash flow (incl. except.)	1,637	2,289	1,699	1,134	1,465	1,635	1,938
Free cash flow yield (%)	3.3	4.7	3.5	2.3	3.0	3.3	4.0
Summary balance sheet (€m)							
Fixed Assets	71,680	51,999	54,744	55,512	56,466	60,575	64,634
Current Assets	37,778	41,456	32,722	35,396	36,628	36,490	36,302
Total Assets	109,458	93,455	87.465	90 908	93.094	97.065	100 935
Shareholders' Funds	12,357	14,111	15,516	17,639	18,974	20,928	22,805
Current Liabilities	27,452	19,382	19,282	19,182	19,082	19,934	20,708
Provisions	28,064	28,632	20,892	21,166	21,575	21,996	22,429
Long-term liabilities	41,585	31,330	31,776	32,921	33,463	34,206	34,993
Equity & Liabilities	109,458	93,455	87 465	90.908	93.094	97 065	100.935
BVPS	20.33	23.90	26.39	30.17	32.54	36.02	39.35
Stated Net Debt/(Cash)(incl. pen. prov)	23,435	6,864	6,803	4,124	2,536	3,551	4,490
Nuclear provisions	8,675	8,834	8,877	8,936	8,995	9,054	9,115
Rating net debt / (cash)	32,110	15,698	15,680	13,059	11,531	12,606	13,604
Net debt / EBITDA (x)	4.5	2.0	1 8	1 4	1 2	1 2	1 3
Net Gearing (stated net debt) (%)	205.0	51.1	45 8	24 3	13 9	17.5	20 3

Source: Company data, Dresdner Kleinwort Research estimates

Assumption: American Water Works deconsolidated from end **2008**; discontinued operations afterwards

RWE Outlook, Nov 2007: "5-10%"

RWE Outlook, Nov 2007: "10-15%"

Thames Water plc
€330m income from TW
€725m book gain
€266m unwinding of hedges

RWE Outlook, Nov 2007: "decrease substantially"

RWE Outlook, Nov 2007: "gain of at least 15%"

Thames Water related increase in payout ratio to "70-80% of recurrent net income

American Water Works related increase in payout ratio to "70-80% of recurrent net income

Assumption:
2008: 51% of AWW
2009: 49% of AWW
Assumed value of 100%: **$9.37bn**, €6 46bn

Step-up in core capex (despite water disposals) starts to hit free CF

RWE 9m, Nov 2007: €4,980m

To get to a net debt/EBITDA of 3-3 5x RWE could spend **€19-24bn**

Dresdner Kleinwort

Utilities sector outlook 2008

13 December 2007

Buy

Unchanged

Current	€82.1
Target	**€92.0**
Previous	€86.0

Current price equivalent
US$120.5

Market cap
€149.7bn
US$219bn

52-week high/low
€85.7/€51.5

Price performance	1M	3M	12M
Price (€)	81.3	71.3	53.0
Absolute (%)	1.0	15.2	55.0
Rel market (%)	-1.4	13.0	48.1
Rel sector (%)	-1.7	1.4	28.1
EPS change	**1M**	**3M**	**12M**
EPS FY1 (%)	-6.8	-6.8	10.2
IBES EPS (%)	-0.2	-0.7	7.1
Sector EPS (%)	-0.3	-1.5	2.9
Market EPS (%)	-1.1	-2.1	0.6

Source: DKIB Research, Thomson IBES

Reuters	Bloomberg
EDF.PA	EDF FP Equity

Sum-of-the-parts valuation

€bn		Valuation basis
France - G/S	124,101	DCF
France – reg.	39,002	RAB-based
EnBW	14,632	8.3x 2009 EBITDA
Edf Energy	13,993	8.3x 2009 EBITDA
Italy	12,420	8.3x 2009 EBITDA
R.o.E	11,016	8.3x 2009 EBITDA
R.o.W	3,008	8.3x 2009 EBITDA
Total EV	218,173	
Net debt	-7,399	
Minorities	-2,378	
Provisions	-52,123	
Equity holdings	2,648	
Financial inv.	8,569	
Equity valuation	167,490	
No. shares	1822	
Target Price	92	

Source: DKIB Research estimates

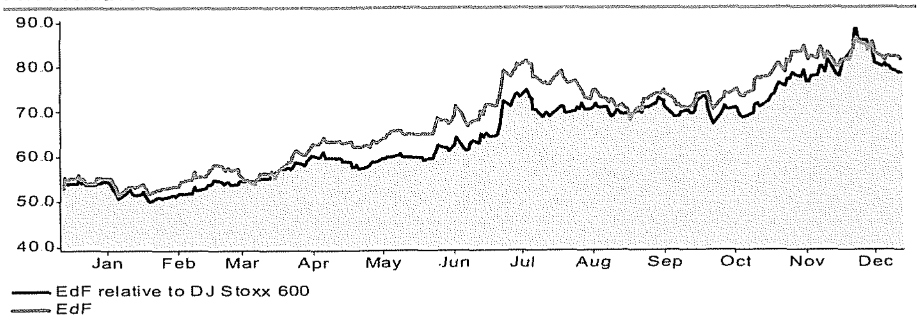
EDF

Ding dong merrily on high

EDF is the ultimate power price play. However, investing in the company is a call on how quickly regulated tariffs can rise in order to better reward its generation fleet. Our €92 PT assumes that power prices reach nuclear new entrant cost-€46/MWh, by 2011 facilitated by conservative business and residential tariff rises. However, pressure from the EC could mean prices rise quicker than forecast.

- **Current market perception:** EDF's role in the power price story is beginning to be appreciated by the market, although future political and regulatory developments are still a major concern. The main uncertainty relates to how quickly rising power prices will translate into the company's P/L due to increases in regulated tariffs. The recent share placing by the government was welcome but turned out smaller than expected.
- **Dresdner Kleinwort view:** EDF is the ultimate power play in the current high commodity price environment, having the highest gearing into power prices of all of the European genco's. We forecast EDF's achieved generation price to rise from €33/MWh in 2006 to €49.2/MWh by 2012 driven by conservative assumptions on business and residential tariff inflation.
- **Risks to Dresdner Kleinwort view:** EDF's achieved generation prices are unlikely to decline but the political risk from the government could mean that increases are slower to manifest than forecast. EDF's strong balance sheet means that re-investment risk is still a concern.
- **Upcoming events:** The EC should determine in the next few months if the tariffs for business customers constitute state-aid. We expect the EC to continue applying pressure on the government to abolish regulated pricing which is preventing full liberalisation. Secondly, the government will decide on the creation of a "return tariff" for residential users who have exercised their eligibility.

Price relative



Source: RIMES

Year to end Dec	Sales €m	Pre-tax profit €m	Dil EPS excl except €	EBITDA €m	CFPS €	P/E x	P/CF x	Yield %	EV/ EBITA x	EV/EBITDA x
2006	58,932	5,277	2.32	13,930	6.11	35.5	13.4	1.4	25.5	14.6
2007E	62,156	7,206	3.14	15,612	7.34	26.2	11.2	1.9	20.0	12.9
2008E	65,051	9,070	3.81	17,754	8.03	21.6	10.2	2.3	16.6	11.2
2009E	67,768	10,577	4.35	19,548	8.68	18.9	9.5	2.6	14.5	10.2

Source: Company data, Dresdner Kleinwort Research estimates

Research Analysts
Scott Phillips
+44 (0)20 7475 4967
scott.phillips@dkib.com

Please refer to the Disclosure Appendix for all relevant disclosures and our disclaimer.

EdF – summary information

2007 hit by mild winter weather

Higher tariff increases post-2010

Dividend policy
- payout ratio of 50% of recurring net income

Significant cash generation presents re-investment risk

	2006	2007E	2008E	2009E	2010E	2011E	2012E
Sales	58,932	62,156	65,051	67,768	70,050	72,531	75,933
EBITDA	13,930	15,612	17,754	19,548	20,797	22,230	24,546
EBIT	9,356	10,045	12,050	13,702	14,807	16,092	18,257
Financial result	-2,701	-2,839	-2,980	-3,126	-3,277	-3,433	-3,595
PBT	6,655	7,206	9,070	10,577	11,531	12,659	14,662
Tax	-1,146	-1,588	-2,229	-2,748	-3,077	-3,465	-4,155
PAT	5,509	5,618	6,840	7,829	8,454	9,194	10,507
Minorities	-172	-181	-190	-199	-209	-220	-230
Other income	268	276	290	304	320	336	352
Net income (reported)	5,605	5,714	6,941	7,934	8,565	9,310	10,629
Extraordinary items	-1,378	-	-	-	-	-	-
Net income (recurring)	4,227	5,714	6,941	7,934	8,565	9,310	10,629
EPS (recurring)	2.32	3.14	3.81	4.35	4.70	5.11	5.83
DPS (recurring)	1.16	1.57	1.90	2.18	2.35	2.55	2.92
Fixed assets	130,824	132,145	134,394	137,788	141,351	144,949	148,255
Current assets	48,262	52,886	56,781	59,996	63,248	66,951	71,956
Total assets	179,086	185,032	191,175	197,783	204,599	211,900	220,211
Shareholders equity	24,799	28,304	32,287	36,645	41,132	46,044	51,896
Current liabilities	40,904	41,630	42,187	42,774	43,378	43,979	44,581
Non-current liabilities	113,383	115,097	116,701	118,364	120,089	121,878	123,734
Total equity / liabilities	179,086	185,032	191,175	197,783	204,599	211,900	220,211
Net debt (EDF)	14,932	10,897	7,399	4,582	1,623	-1,701	-6,014
Operating cash flow	11,232	12,967	14,238	15,456	16,408	17,273	18,493
Core cap-ex	-5,935	-6,818	-7,883	-9,169	-9,483	-9,666	-9,525
Disposals	272	-	-	-	-	-	-
Cash flow pre acquisitions	6,132	6,149	6,355	6,287	6,925	7,606	8,968
Acquisitions	-8,106	-	-	-	-	-	-
Dividend	-1,532	-2,114	-2,857	-3,470	-3,967	-4,282	-4,655
Cash flow post acquisitions	-3,506	4,035	3,498	2,817	2,958	3,324	4,313
Other cash movements	-406	-	-	-	-	-	-
Increase / (decrease) in cash	-3,912	4,035	3,498	2,817	2,958	3,324	4,313

Source: Company data, *Dresdner Kleinwort Research estimates*

Error

An error occurred while processing this page. See the system log for more details.

Profit & Loss

Consolidation of Endesa from 4Q07 through the proportional method

Consolidation of OGK-5 from 2Q08

Effect of higher CO2 prices and higher coal prices

Capital gain related to the disposal of assets to EON

(€m)	2004	2005	2006	2007E	2008E	2009E	2010E
Sales	37,414.0	34,059.0	38,513.0	38,415.8	39,609.1	41,395.6	42,410.2
Endesa (67% stake)	0.0	0.0	0.0	3,745.7	15,661.0	16,425.9	17,228.8
OGK-5 (100% stake)	0.0	0.0	0.0	0.0	764.4	1,381.2	2,073.8
Total revenues	37,414.0	34,059.0	38,513.0	42,161.5	56,034.5	59,202.8	61,712.8
% Incr	19.5	-9.0	13.1	9.5	32.9	5.7	4.2
Purchases	-17,135.0	-20,633.0	-24,083.0	-22,669.5	-22,894.1	-24,220.2	-24,867.7
Purchases - Endesa	0.0	0.0	0.0	-1,811.6	-7,575.3	-8,027.9	-8,507.1
Purchases - OGK-5	0.0	0.0	0.0	0.0	-471.3	-754.4	-946.3
Operating Expenses - Enel	-9,311.0	-5,681.0	-6,411.0	-6,796.0	-8,231.0	-8,365.7	-8,440.1
Operating Expenses - Endesa	0.0	0.0	0.0	-664.5	-2,750.8	-2,853.1	-2,959.8
Operating Expenses - OGK-5	0.0	0.0	0.0	0.0	-133.0	-213.9	-284.0
Assets sold to EON	0.0	0.0	0.0	0.0	-1,250.0	-1,275.0	-1,300.5
Synergies - Endesa	0.0	0.0	0.0	0.0	80.0	160.0	240.0
EBITDA	10,968.0	7,745.0	8,019.0	10,220.0	12,809.1	13,652.5	14,647.4
% Incr	11.5	-29.4	3.5	27.4	25.3	6.6	7.3
EBITDA - Breakdown							
EBITDA - Enel	10,968.0	7,745.0	8,019.0	8,950.3	8,484.0	8,809.7	9,102.4
EBITDA - Endesa	0.0	0.0	0.0	1,269.6	5,334.9	5,544.9	5,761.9
EBITDA - OGK-5	0.0	0.0	0.0	0.0	160.1	412.9	843.5
EBITDA – Ass Endesa to be sold	0.0	0.0	0.0	0.0	-1,250.0	-1,275.0	-1,300.5
Synergies - Endesa	0.0	0.0	0.0	0.0	80.0	160.0	240.0
TOTAL EBITDA	10,968.0	7,745.0	8,019.0	10,220.0	12,809.1	13,652.5	14,647.4
Depreciation	-4,891.0	-2,207.0	-2,463.0	-2,939.7	-3,016.2	-3,094.3	-3,173.8
Goodwill amortization	-512.0	0.0	0.0	0.0	0.0	0.0	0.0
Provisions	0.0	0.0	263.0	0.0	0.0	0.0	0.0
Depreciation - Endesa	0.0	0.0	0.0	-328.9	-1,354.2	-1,390.7	-1,397.2
Depreciation - OGK-5	0.0	0.0	0.0	0.0	-63.1	-101.0	-112.7
TOTAL EBIT	5,565.0	5,538.0	5,819.0	6,951.3	8,375.6	9,066.5	9,963.6
% Incr	17.6%	-0.5%	5.1%	19.5%	20.5%	8.2%	9.9%
Net Financial Expenses	-1,320.0	-714.0	-647.0	-1,060.7	-2,657.7	-2,665.5	-2,578.5
Equity Consolidation	0.0	-30.0	-4.0	32.1	104.1	122.8	145.1
ORDINARY EBT	4,245.0	4,794.0	5,168.0	5,922.7	5,822.0	6,523.8	7,530.2
Extraordinaries	0.0	1,272.0	0.0	0.0	2,500.0	0.0	0.0
EBT	4,245.0	6,066.0	5,168.0	5,922.7	8,322.0	6,523.8	7,530.2
Taxes (%)	35	32	40	40	37	37	37
Taxes	-1,498.0	-1,934.0	-2,067.0	-2,369.1	-3,079.1	-2,413.8	-2,786.2
Minorities	-134.0	-237.0	-65.0	-168.9	-505.1	-574.1	-710.6
NET INCOME	2,613.0	3,895.0	3,036.0	3,384.7	4,737.7	3,535.9	4,033.4
Growth (%)	4.1	49.1	-22.1	11.5	40.0	-25.4	14.1

Source: Company data, Dresdner Kleinwort Research estimates

ENEL - Balance Sheet

Includes the disposal of assets to EON for €10.0bn

Debt/EBITDA should be at around 3.2x, below Enel's targeted 3.5x

	2004	2005	2006	2007E	2008E	2009E	2010E
Total Fixed Assets	36,191	35,978	39,946	93,590	85,410	86,179	85,988
Deferred Cost	328	1,778	1,554	3,357	3,390	3,424	3,458
Debtors	12,795	9,989	9,598	13,147	13,817	14,598	15,217
Cash & Equivalents	1,170.0	2,757	3,402	4,128	4,211	4,295	4,381
Total Assets	50,484	50,502	54,500	114,222	106,828	108,497	109,044
Share capital	6,063	6,157	6,176	6,176	6,176	6,176	6,176
Reserves	11,894	12,900	12,284	12,284	13,991	14,497	15,438
Minorities	1,109	359	565	3,882	4,125	4,380	4,653
Deferred Income	1,009	2,464	2,504	4,157	4,198	4,240	4,282
Provisions for Risks	4,281	1,267	4,151	7,127	7,127	7,127	7,127
Provisions (Employee Indemnities)	973	2,662	2,633	2,633	2,633	2,633	2,633
Debt	11,096	12,312	12,513	58,664	48,102	47,922	46,705
Other Liabilities	14,059	12,381	13,674	19,299	20,476	21,521	22,029
Total Liabilities	50,484	50,502	54,500	114,222	106,828	108,497	109,044
Control	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Company data, Dresdner Kleinwort Research estimates

Buy

Unchanged

Current €21.2
Target €23.5

Current price equivalent
US$31.1

Market cap
€5,052m
US$7,411m

52-week high/low
€21.5/€16.3

Price performance	1M	3M	12M
Price (€)	19 6	17.6	20 2
Absolute (%)	7 8	20 4	5 0
Rel market (%)	4 5	17.2	-0 5
Rel sector (%)	4.1	5.2	-14.0
EPS change	**1M**	**3M**	**12M**
EPS FY1 (%)	-2 9	-2 9	-4 1
IBES EPS (%)	-0 3	-0 3	-3 6
Sector EPS (%)	-0 3	-1 5	2 9
Market EPS (%)	-1.1	-2.1	0.6

Source: DKIB Research, Thomson IBES

Reuters	Bloomberg
ENAG.MC	ENG SM Equity

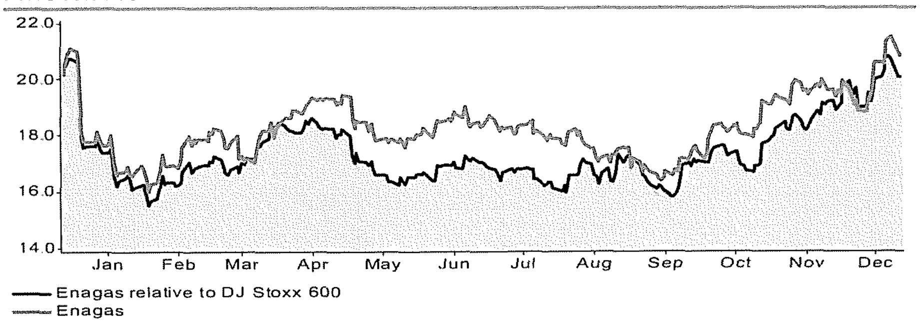
Enagas

Have yourself a merry little Christmas

Our Buy case on Enagas is based on our conviction that Spanish government regulation to be announced before the end of the year will be supportive for Enagas, allowing the company to realise its ambitious capex plans. We believe the fact that the Spanish state has recently acquired a 5% stake is very reassuring.

- **Current market perception:** We believe the market is still sceptical on regulated utilities in Spain after a recent high level of political intervention by the Spanish government.
- **Dresdner Kleinwort view:** We believe that Government needs Enagas to ensure the completion of the much-needed development of gas transmission infrastructure. The Government is to extend the NEP to 2016 before year-end. Our model assumes capex of €4.0bn in 2007-2012 and €2.0bn of additional expansion capex in the period 2013-18. Furthermore, our DCF valuation is based on the following assumptions on new regulation: (1) Pipelines opened before end-2007 maintain the existing regulatory framework during their whole useful life; (2) For pipelines, re-gasification plants and storage facilities opened after 2007, regulation will guarantee a post-tax IRR of 7%, without considering efficiency gains.
- **Risks to Dresdner Kleinwort view:** The government failure to provide Enagas with the required incentives for its development plan could significantly damage our case.
- **Upcoming events:** New regulation should be approved before the year-end and the company will hold a strategy update in February (date to be confirmed).

Price relative



Source: RIMES

Year to end Dec	Sales €m	Net income €m	Dil EPS Incl except €	CFPS €	DPS €	P/E x	P/CF x	Yield %	EV/ EBITA x	EV/ EBITDA x
2006	778	216	0 91	1 68	0 47	23 3	12 6	2 2	18 0	12 1
2007E	834	238	1 00	2 10	0 60	21 2	10 1	2 8	16 8	11 5
2008E	942	287	1 20	2 48	0 72	17 6	8 5	3 4	15 1	10 5
2009E	1,058	332	1.39	2 85	0 83	15 2	7 4	3 9	13 7	9 6

Source: Company data, Dresdner Kleinwort Research estimates

Research Analysts
Javier Suarez
+39 02 7240 2344
javier suarez@dkib com

We expect that EBITDA CAGR should stand at 12.7% in 2006-11.

Company is benefited from the reduction of tax rate in Spain from 35% to 30%.

We believe that Net Profit should be at 12.3% in the period 2006-11

Enagas – profit and loss account

(€m)	1999	2000	2001	2002	2003	2004	2005	2006	2007E	2008E	2009E	2010E	2011E
Net Revenues	342.0	307.0	382.2	476.9	531.6	565.9	646.2	733.1	787.7	894.3	1,008.5	1,094.3	1,177.3
Other Revenues	40.0	72.0	51.1	49.2	42.8	46.4	42.9	44.9	46.2	47.6	49.1	50.5	52.1
Total Revenues	382.0	379.0	433.3	526.1	574.4	612.3	689.1	778.0	833.9	942.0	1,057.6	1,144.9	1,229.4
Growth (%)		-1	14	21	9	7	13	13	7	13	12	8	7
Other oper. expenses	-134.0	-166.0	-184.0	-192.4	-191.4	-193.2	-210.7	-214.4	-220.8	-227.5	-234.3	-241.3	-248.5
Operating Margin/EBITDA	248.0	213.0	249.3	333.7	383.0	419.1	478.4	563.6	613.1	714.5	823.3	903.6	980.8
Growth (%)		-14	17	34	15	9	14	18	9	17	15	10	9
Depreciation	-108.0	-109.0	-111.3	-126.5	-133.5	-144.8	-145.6	-184.9	-192.8	-220.1	-246.0	-270.5	-293.7
Provisions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Operating profit/EBIT	140.0	104.0	138.0	207.2	249.5	274.3	332.8	378.7	420.3	494.4	577.3	633.0	687.2
Growth (%)		-26	33	50	20	10	21	14	11	18	17	10	9
Financial revenues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial expenses	2.0	-20.0	-40.0	-39.4	-31.7	-33.0	-40.4	-47.0	-70.3	-85.0	-103.5	-120.9	-133.8
Ordinary EBT	142.0	84.0	98.0	167.8	217.8	241.3	292.4	331.7	350.0	409.4	473.8	512.1	553.4
Extraordinaries	0.0	0.0	60.2	1.2	-0.4	1.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EBT	142.0	84.0	158.2	169.0	217.4	242.6	292.4	331.7	350.0	409.4	473.8	512.1	553.4
Tax rate (%)	33.1	35.7	25.4	34.9	34.7	34.8	34.7	34.8	32.0	30.0	30.0	30.0	30.0
Taxes	-47.0	-30.0	-40.2	-59.0	-75.4	-84.5	-101.4	-115.3	-112.0	-122.8	-142.1	-153.6	-166.0
Net Income	95.0	54.0	118.0	110.0	142.0	158.1	191.0	216.4	238.0	286.6	331.6	358.5	387.4
Growth (%)		-43.2	118.5	-6.8	29.1	11.3	20.8	13.3	10.0	20.4	15.7	8.1	8.1

Source: Company data, Dresdner Kleinwort Research estimates

Debt should peak at €3.7bn in 2012-14 to decrease onwards.

Enagas – balance sheet

(€m)	2001	2002	2003	2004	2005	2006	2007E	2008E	2009E	2010E	2011E
Gross Fixed Assets	2,310.9	2,363.1	2,649.4	2,967.9	2,795.6	3,075.2	3,575.2	4,082.4	4,562.3	5,016.2	5,445.7
Depreciation	0.0	0.0	0.0	0.0	0.0	0.0	-192.8	-220.1	-246.0	-270.5	-293.7
Goodwill	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net financial Assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Deferred costs	20.8	24.6	28.3	20.3	17.9	9.4	9.5	9.6	9.7	9.8	9.9
Debtors	416.8	503.5	406.4	474.9	404.4	525.3	646.8	730.6	820.2	888.0	953.5
Cash & Equivalents	6.1	4.5	8.9	8.6	7.7	16.3	17.5	19.7	22.2	24.0	25.8
Total Assets	2,754.6	2,895.7	3,093.0	3,471.7	3,225.6	3,626.2	4,056.2	4,622.2	5,168.3	5,667.4	6,141.2
Share Capital	779.6	852.4	932.3	1,017.3	1,110.4	1,235.2	1,235.2	1,235.2	1,235.2	1,235.2	1,235.2
Reserves	0.0	0.0	0.0	0.0	0.0	0.0	95.2	209.8	342.5	485.9	640.8
Deferred income	479.5	476.1	451.2	425.4	2.4	2.1	2.1	2.1	2.2	2.2	2.2
Provisions	1.3	2.1	4.7	10.9	16.6	16.7	16.7	16.7	16.7	16.7	16.7
Financial Debt	1,070.0	1,255.9	1,240.3	1,398.7	1,564.2	1,782.1	2,017.1	2,454.0	2,852.7	3,193.5	3,497.1
Other Liabilities	424.2	309.2	464.5	619.4	532.0	590.1	689.8	704.3	719.0	734.0	749.2
Total Liabilities	2,754.6	2,895.7	3,093.0	3,471.7	3,225.6	3,626.2	4,056.2	4,622.2	5,168.3	5,667.4	6,141.2
Control	0.0	0.0	0.0	0.0	0.0	0.0	0	0	0	0	0

Source: Company data, Dresdner Kleinwort Research estimates

We assume a 60% pay-out policy to 2014. DPS should grow by 13% in 2006-12

Enagas – cash flow statement (2007-11E)

(€m)	2007E	2008E	2009E	2010E	2011E
Net Income	238.0	286.6	331.6	358.5	387.4
Non Cash Items	192.8	220.1	246.0	270.5	293.7
Operating cash flow	430.8	506.7	577.7	629.0	681.0
Capex	-500.0	-700.0	-700.0	-700.0	-700.0
Variation in Work. Cap. & others	-21.8	-69.4	-75.0	-52.8	-50.4
GENERATED CASH FLOW	-91.0	-262.7	-197.3	-123.8	-69.4
Dividends	-142.8	-172.0	-199.0	-215.1	-232.4
Net Cash Flow (Balance Sheet)	-233.8	-434.6	-396.3	-338.9	-301.8
Year-end Debt	2,017.1	2,454.0	2,852.7	3,193.5	3,497.1
Debt / Equity (%)	152%	170%	181%	186%	186%

Source: Company data, Dresdner Kleinwort Research estimates

European utility companies ordered by country

	Curr	Share price	Rec	Price target 6-9M	Up/down side %	Free float €bn	Mkt cap €bn	Firm value €bn	Year-end	EV/EBITDA[1] x FY1 2007A/E	EV/EBITDA[1] x FY2 2008E	EV/EBITDA[1] x FY3 2009E	EBITDA[1] 07-10E CAGR %	P/E[1] x FY1 2007A/E	P/E[1] x FY2 2008E	P/E[1] x FY3 2009E	EPS[1] 07-10E CAGR %	FCF yield % FY1 2007A/E	FCF yield % FY2 2008E	FCF yield % FY3 2009E	Div yld[1] FY1 2008E[2]	DPS[1] 07-10E CAGR %	Perf rel to MSCI Europe % -1M	Perf rel to MSCI Europe % -3M	Perf rel to MSCI Europe % YTD
Czech Republic																									
CEZ	€	1391	Add	1500	7.8	8.5	28.3	31.8	Dec	11.6	9.1	7.9	12.0	22.7	15.4	12.6	23.6	3.8	4.9	5.5	3.3	24.9	7.1	35.7	51.9
Finland																									
Fortum	€	29.3	Add	31.0	5.8	12.6	26.0	29.1	Dec	12.6	11.7	10.2	8.6	20.1	19.5	16.4	9.2	3.9	3.3	4.3	3.1	6.9	-3.7	20.0	31.9
France																									
EDF	€	81.2	Buy	92.0	13.3	22.5	148.0	197.6	Dec	12.8	11.1	10.0	10.0	25.9	21.3	18.6	14.4	3.8	4.0	3.9	2.3	14.4	-1.2	13.1	44.2
Gaz de France	€	39.4	Buy	43.3	9.9	6.8	38.8	44.6	Dec	7.4	7.3	6.9	3.6	13.4	12.8	11.6	5.6	2.7	3.9	5.6	3.4	6.6	2.7	16.7	10.6
Suez	€	45.6	Buy	48.1	5.5	44.6	57.9	72.4	Dec	10.0	8.9	8.1	8.4	17.4	15.1	13.7	10.6	4.2	5.2	5.9	3.3	15.0	2.6	19.6	14.5
Veolia Environnement	€	64.0	Hold	60.0	-6.3	21.0	26.3	39.8	Dec	8.9	8.3	7.7	7.4	28.3	25.1	22.3	12.3	1.7	2.2	2.8	2.2	14.5	-1.4	10.0	6.8
Germany																									
E.ON	€	142.9	Buy	158.0	10.6	69.0	87.3	125.1	Dec	7.5	7.6	6.8	14.1	18.8	14.4	12.0	12.0	2.8	0.4	4.5	3.8	21.3	5.0	15.4	36.0
RWE	€	94.8	Buy	108.0	13.9	37.3	53.3	75.4	Dec	8.7	8.0	7.7	4.7	16.7	13.4	12.4	13.3	4.1	2.4	2.8	5.6	17.3	-0.5	16.8	11.5
Italy																									
Enel	€	8.3	Buy	9.3	11.8	34.5	51.5	102.2	Dec	11.0	8.0	7.5	12.7	15.2	10.9	14.6	6.0	-89.0	20.9	0.9	5.9	0.7	1.1	5.9	3.3
Snam Rete Gas	€	4.4	Add	4.55	2.5	3.1	7.8	14.1	Dec	9.3	9.0	9.1	2.3	16.9	15.2	15.4	-0.1	1.1	-0.4	-1.9	5.3	4.4	1.9	-0.4	1.2
Terna	€	2.7	Add	2.75	1.1	2.7	5.4	8.4	Dec	8.9	9.0	9.0	3.3	16.3	15.8	15.6	3.3	1.5	1.0	0.5	5.7	6.0	0.1	5.2	2.9
Portugal																									
EDP	€	4.7	Hold	4.1	-11.8	11.1	17.0	32.2	Dec	10.3	9.3	9.1	9.4	18.4	14.4	14.4	0.0	-1.0	-2.6	-0.5	3.0	10.8	-8.0	15.7	16.6
Spain																									
Aguas de Barcelona	€	27.4	Reduce	27.0	-1.5	1.7	4.2	7.7	Dec	10.6	10.2	9.9	7.3	25.9	23.5	22.1	10.6	-1.8	-1.4	-1.1	1.9	9.7	-2.0	1.4	-3.8
Enagas	€	20.9	Buy	23.5	12.4	3.2	5.0	7.4	Dec	11.4	10.4	9.5	13.8	21.0	17.4	15.0	14.6	-1.8	-5.3	-4.0	3.5	13.8	5.8	18.6	16.7
Endesa	€	37.9	Hold	38.8	2.2	37.7	40.1	63.0	Dec	8.4	7.9	7.3	5.9	15.1	13.8	12.3	10.4	5.1	6.8	7.2	4.7	11.0	2.6	-7.9	1.5
Gas Natural	€	43.1	Hold	40.5	-6.0	7.7	19.3	24.6	Dec	10.5	9.7	8.8	8.8	21.0	18.6	16.8	9.1	0.1	1.1	4.4	3.0	10.8	-3.0	15.3	38.2
Iberdrola	€	10.9	Hold	11.0	0.9	34.4	51.3	72.9	Dec	11.5	9.3	8.6	13.1	19.0	17.1	15.5	12.3	-10.0	-0.7	3.7	3.5	12.3	-8.6	12.6	28.2
Red Electrica	€	42.2	Add	40.0	-5.2	3.3	5.7	8.8	Dec	12.0	10.5	9.5	12.2	24.3	19.2	16.5	19.0	-4.9	-0.1	1.1	3.2	19.0	7.4	25.3	28.9
Union Fenosa	€	45.5	Hold	42.5	-6.6	11.7	13.9	20.4	Dec	8.8	8.5	8.1	8.2	16.0	14.8	13.8	6.8	0.3	1.5	1.8	3.7	15.3	-4.9	19.1	19.1
UK Energy																									
British Energy	p	521	Hold	490	-6.0	7.4	11.4	10.6	Mar	9.3	8.0	6.2	12.4	19.1	16.8	12.8	15.2	-0.2	7.5	12.8	6.0	21.5	-0.6	1.1	-10.6
Centrica	p	367	Sell	325	-11.4	18.6	18.6	20.4	Dec	6.3	6.6	7.0	-4.7	11.1	12.9	13.4	-5.4	7.7	5.8	5.4	3.7	2.5	-0.5	-7.1	-4.4
Drax	p	680	Hold	620	-8.8	3.2	3.2	3.8	Dec	5.1	7.1	7.7	-9.0	6.8	9.2	10.3	-8.2	12.2	7.5	8.2	7.5	19.8	-4.2	2.9	-23.5
International Power	p	446	Add	465	4.3	9.3	9.3	15.0	Dec	9.7	9.0	8.4	5.0	16.3	15.0	13.9	8.0	5.7	6.1	6.5	2.5	10.0	-8.0	2.5	10.4
National Grid	p	838	Add	740	-11.7	28.2	28.2	53.5	Mar	10.6	9.5	9.4	5.5	17.2	15.9	15.4	4.1	-0.4	0.8	0.9	4.3	7.3	3.3	7.2	4.0
Scottish & Southern Energy	p	1617	Reduce	1420	-12.2	19.4	19.4	23.0	Mar	11.3	10.4	9.6	5.9	15.1	13.8	13.1	5.2	2.0	4.0	4.6	4.0	6.8	3.2	9.5	-3.7
UK Water																									
Northumbrian	p	345	Add	320	-7.2	1.9	2.5	5.4	Mar	10.3	9.6	9.4	0.7	14.1	12.9	13.2	-3.4	1.1	3.5	5.0	3.7	5.3	7.4	-3.3	1.6
Pennon	p	656	Add	630	-4.0	3.2	3.2	5.5	Mar	10.9	10.0	9.6	3.5	20.4	17.6	16.7	3.3	-0.4	2.0	3.0	3.1	5.7	6.9	2.9	5.3
Severn Trent	p	1524	Hold	1490	-2.2	4.9	4.9	9.8	Mar	10.3	10.1	9.5	3.4	17.1	15.7	13.9	3.7	0.2	-0.4	0.1	4.5	5.3	6.3	5.8	-5.2
United Utilities	p	769	Hold	725	-5.7	8.1	8.1	14.3	Mar	10.2	10.1	8.6	2.8	19.0	14.4	12.5	6.6	-1.7	0.7	4.6	4.2	-8.3	9.1	8.5	-9.1
Totals/weighted averages																									
Continental Europe						365	659	946		10.3	9.0	8.3	9.6	19.9	16.6	15.1	11.4	-4.9	3.8	3.6	3.6	13.6	-0.4	11.8	21.8
United Kingdom						104	109	161		9.8	9.2	8.7	3.7	15.7	14.6	13.8	3.4	2.3	3.5	4.4	4.2	6.5	0.5	1.4	-5.2
Pan-Europe						469	767	1107		10.2	9.1	8.4	8.7	19.3	16.3	14.9	10.3	-4.0	3.8	3.7	3.7	12.6	-0.3	10.5	18.0

[1] For companies with a March year end, 2007 refers to the financial year ending in 2008. For companies with a December year end, 2007 refers to the financial year ending in 2007. Similarly for 2008 and 2009. [2] 2008E within this column denotes the next estimated dividend for the company

Our price targets reflect the value of the companies based on fundamentals. Recommendations are generally in line with these fundamental valuations but can vary due to factors such as M&A activity

Source: RIMES, Dresdner Kleinwort Research estimates

Notes

Notes

Notes

Disclosure appendix

Disclosures under US regulations

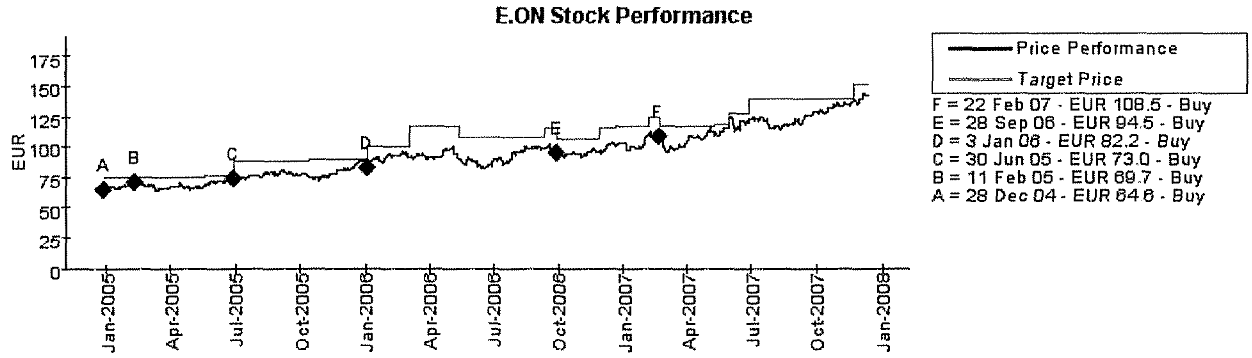
A current or former member of the Supervisory Board or Board of Managing Directors of Allianz SE or Dresdner Bank AG or an employee of Dresdner Bank AG and/or its subsidiaries is a member of Aufsichtsrat of E.ON. Dresdner Kleinwort or an affiliate has received compensation from E.ON for non-investment banking securities services in the past 12 months. Dresdner Kleinwort or an affiliate has received compensation from E.ON for non securities services in the past 12 months. Dresdner Kleinwort or an affiliate has a beneficial interest in 1% or more of the equity of E.ON. Dresdner Kleinwort or an affiliate has received compensation from E.ON for investment banking services in the past 12 months. Dresdner Kleinwort or an affiliate has received compensation from EDF for non securities services in the past 12 months. Dresdner Kleinwort or an affiliate has received compensation from EDF for investment banking services in the past 12 months. Dresdner Kleinwort or an affiliate has received compensation from Enel for non-investment banking securities services in the past 12 months. Dresdner Kleinwort or an affiliate has received compensation from Enel for non securities services in the past 12 months. Dresdner Kleinwort or an affiliate has a beneficial interest in 1% or more of the equity of Enel. Dresdner Kleinwort or an affiliate has received compensation from Enel for investment banking services in the past 12 months. A current or former member of the Supervisory Board or Board of Managing Directors of Allianz SE or Dresdner Bank AG or an employee of Dresdner Bank AG and/or its subsidiaries is a member of Aufsichtsrat of RWE. Dresdner Kleinwort or an affiliate has received compensation from RWE for non-investment banking securities services in the past 12 months. Dresdner Kleinwort or an affiliate has received compensation from RWE for non securities services in the past 12 months. Dresdner Kleinwort or an affiliate has a beneficial interest in 1% or more of the equity of RWE. Dresdner Kleinwort or an affiliate has received compensation from RWE for investment banking services in the past 12 months.

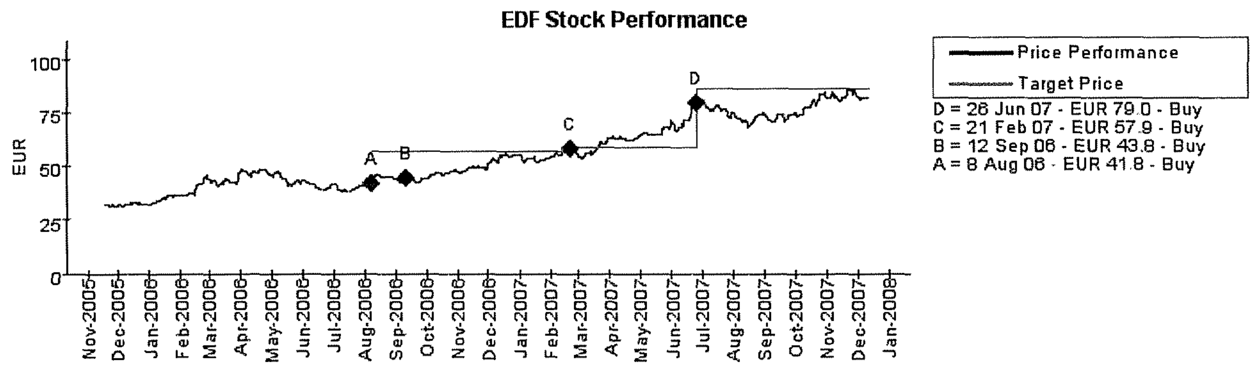
The relevant research analyst(s), as named on the front cover of this report, certify that (a) all of the views expressed in this research report accurately reflect their personal views about the securities and companies mentioned in this report; and (b) no part of their compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or views expressed by them contained in this report.

Any forecasts or price targets shown for companies and/or securities discussed in this report may not be achieved due to multiple risk factors including without limitation market volatility, sector volatility, corporate actions, the unavailability of complete and accurate information and/or the subsequent transpiration that underlying assumptions made by Dresdner Kleinwort or by other sources relied upon in the report were inapposite.

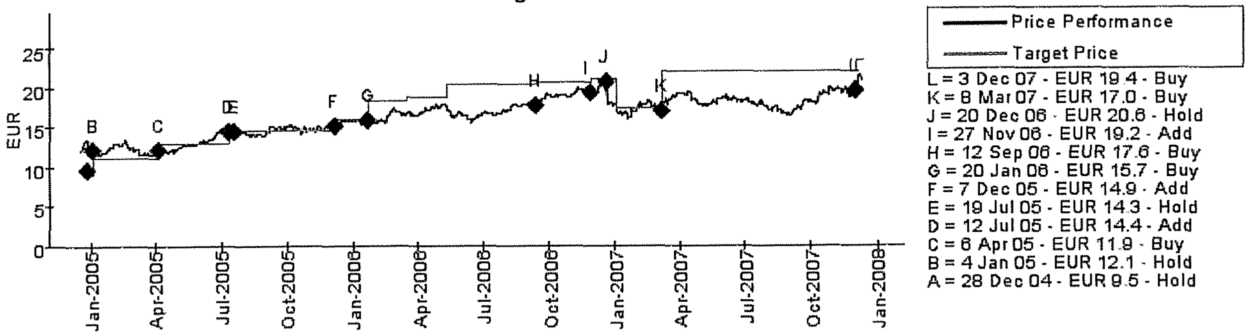
Recommendation history charts

Past performance is not an indicator of future performance.

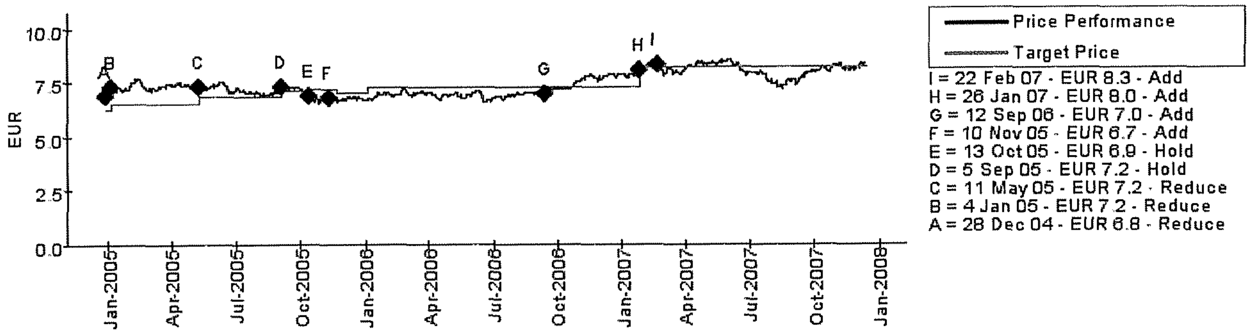




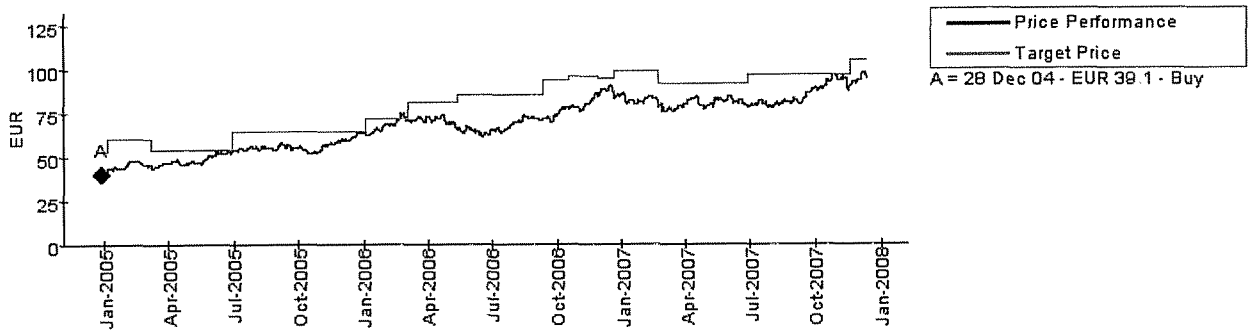
Enagas Stock Performance



Enel Stock Performance



RWE Stock Performance



Dresdner Kleinwort Research – Recommendation definition

(Except as otherwise noted, expected performance over next 12 months)

Buy:	10% or greater increase in share price	Sell:	10% or more decrease in share price
Add:	5-10% increase in share price	Reduce:	5-10% decrease in share price
Hold:	+5%/-5% variation in share price		

Distribution of Dresdner Kleinwort equity recommendations as of 30 Sep 2007

	All covered companies		Companies where a Dresdner Kleinwort company has provided investment banking services (in the last 12 months)	
Buy/Add	373	64%	116	31%
Hold	138	24%	25	16%
Sell/Reduce	69	12%	7	10%
Total	**580**		**148**	

Source: Dresdner Kleinwort Research

Additional disclosures under other non-US regulations

The disclosures under US regulations above should be read together with these additional disclosures.

Dresdner Kleinwort or an affiliate regularly holds trading positions in the shares of E.ON. Dresdner Kleinwort or an affiliate regularly holds trading positions in the shares of EDF. Dresdner Kleinwort or an affiliate regularly holds trading positions in the shares of Enagas. Dresdner Kleinwort or an affiliate managed, co-managed or was a syndicate member for a public offering of debt securities for Enel in the last 12 months. Dresdner Kleinwort or an affiliate regularly holds trading positions in the shares of Enel. Dresdner Kleinwort or an affiliate regularly holds trading positions in the shares of RWE.

In respect of any compendium report covering six or more listed companies, please refer to the following website for all relevant disclosures: www.dresdnerkleinwort.com/research/disclosures
Unless otherwise noted, the securities mentioned in this report are priced as of 12 December 2007 at 10:00. Time given is local to the address shown at the bottom of the first page of this report.

Disclaimer

This report has been prepared by Dresdner Kleinwort, by the specific legal entity named on the cover or inside cover page.

United Kingdom: This report is a communication made, or approved for communication in the UK, by Dresdner Kleinwort Securities Limited (authorised and regulated by the Financial Services Authority and a Member Firm of the London Stock Exchange). It is directed exclusively to eligible counterparties and professional clients. It is not directed at retail clients and any investments or services to which the report may relate are not available to retail clients. No persons other than an eligible counterparty or a professional client should read or rely on any information in this report. Dresdner Kleinwort Securities Limited does not deal for, or advise or otherwise offer any investment services to retail clients.
European Economic Area: Where this report has been produced by a legal entity outside of the EEA, the report has been re-issued by Dresdner Kleinwort Securities Limited for distribution into the EEA. Dresdner Kleinwort Research GmbH is regulated by the Federal Financial Supervisory Authority ('BaFin') by the laws of Germany.
United States: Where this report has been approved for distribution in the US, such distribution is by either: (i) Dresdner Kleinwort Securities LLC; or (ii) other Dresdner Kleinwort companies to US Institutional Investors and Major US Institutional Investors only ; or (iii) if the report relates to non-US exchange traded futures, Dresdner Kleinwort Limited. Dresdner Kleinwort Securities LLC, or in case (iii) Dresdner Kleinwort Limited, accepts responsibility for this report in the US. Any US persons wishing to effect a transaction through Dresdner Kleinwort (a) in any security mentioned in this report may only do so through Dresdner Kleinwort Securities LLC, telephone: (+1 212) 429 2000; or (b) in a non-US exchange traded future may only do so through Dresdner Kleinwort Limited, telephone: (+ 11 44) 20 7623 8000; or (c) in a banking product may only do so through Dresdner Bank AG New York Branch, telephone (+1 212) 969 2700.
Singapore: This research report is being distributed for Dresdner Kleinwort in Singapore by Dresdner Bank AG, Singapore Branch, purely as a resource and for general informational purposes only, and is intended for general circulation. Accordingly, this research report does not take into account the specific investment objectives, financial situation, or needs of any particular person and is exempted from the same by Regulation 34 of the Financial Advisers Regulations ("FAR") (as required under Section 27 of the Financial Advisers Act (Cap. 110) of Singapore ("FAA")).
Hong Kong: This report is being distributed for Dresdner Kleinwort in Hong Kong by Dresdner Kleinwort Securities Limited. Unless permitted to do so by the securities laws of Hong Kong, no person may issue or have in its possession for the purposes of issue this report, whether in Hong Kong or elsewhere, which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong, other than with respect to the securities referred to in this report which are or are intended to be disposed of only to persons outside Hong Kong or only to "professional investors" within the meaning of the Securities and Futures Ordinance (Cap.571) of Hong Kong and any rules made thereunder, and to persons whose ordinary business is to buy and sell shares or debentures.
Japan: Where this report is being distributed in Japan, such distribution is by either (i) Dresdner Kleinwort (Japan) Limited Tokyo Branch (registered and regulated by the Financial Services Agency and General Trading Participant of TSE, Regular Transaction Participant and Transaction Participant in Futures Transaction of OSE, Participant of JASDAQ) to Japanese investors excluding private customers or (ii) other Dresdner Kleinwort companies, to entities falling within the proviso of the Article 58-2 of the Financial Instruments and Exchange Law (the "FIEL") and the Article 17-3 of the Enforcement Order for the FIEL. Any Japanese persons not falling within (ii) wishing to effect a transaction through Dresdner Kleinwort in any security mentioned in this report may only do so through Dresdner Kleinwort (Japan) Limited Tokyo Branch, telephone: (+ 813) 6230 6000.
Australia: Neither Dresdner Bank AG ("DBAG") nor Dresdner Kleinwort Securities Limited holds an Australian financial services licence. This report is being distributed in Australia to wholesale customers pursuant to an Australian financial services licence exemption for DBAG under Class Order 04/1313 or for Dresdner Kleinwort Securities Limited under Class Order 03/1099. DBAG is regulated by BaFin under the laws of Germany and Dresdner Kleinwort Securities Limited is regulated by the Financial Services Authority under the laws of the United Kingdom, both of which differ from Australian laws.
This report contains general information only, does not take account of the specific circumstances of any recipient and should not be relied upon as authoritative or taken in substitution for the exercise of judgment by any recipient. Each recipient should consider the appropriateness of any investment decision having regard to their own circumstances, the full range of information available and appropriate professional advice. The information and opinions in this report constitute judgment as at the date of this report, have been compiled or arrived at from sources believed to be reliable and in good faith (but no representation or warranty, express or implied, is made as to their accuracy, completeness or correctness) and are subject to change without notice. Dresdner Kleinwort may amend, supplement or update the contents of this report in such form and in such timescales as Dresdner Kleinwort deems appropriate. Recommendations and opinions herein reflect Dresdner Kleinwort's expectations over the 12 month period following publication from the perspective of long-only investment clients. Dresdner Kleinwort reserves the right to express different or contrary recommendations and opinions for different timescales or for other types of investment client. This report does not constitute or form part of, and should not be construed as, any offer for sale or subscription of, or any invitation to offer to buy or subscribe for, any securities, nor should it or any part of it form the basis of, or be relied on in any connection with,

2007 ANALYST REPORTS

Morgan Stanley

MORGAN STANLEY RESEARCH
EUROPE

Morgan Stanley & Co. International plc+

Tanja Markloff
Tanja.Markloff@morganstanley.com
+44 (0)20 7425 5141

Bobby Chada

Emmanuel Turpin

Antonella Bianchessi

October 15, 2007

Industry View
Cautious

Utilities

Making a Grab for Power – Prefer RWE to E.ON, CEZ

What's Changed

E.ON	**Resuming at EW; price target €139**
RWE	**Price target raised 10% to €101**
CEZ	**Price target raised 19% to CZK1366**

RWE preferred to CEZ and E.ON after raising targets on new commodity outlook and German tax reform: We raise our price target on RWE (Overweight) by 10% to €101 for 13% implied upside, and thus prefer it to CEZ (Equal-weight) with just 8% upside to our new CZK1366 price target, and to E.ON (Equal-weight) with 9% upside.

E.ON: resuming at Equal-weight, price target €139: E.ON largely prices in benefits from further power price increases and its investment plan, in our view.

RWE offers cheap exposure to rising energy prices… We expect a 10% rise in power prices to €60/MWh on average over the long run. There could also be considerable value in the company's balance sheet, depending on the capital allocation policy of the management team led by the new CEO Dr. Grossmann.

… with an improved risk profile: We believe RWE's risk-reward trade-off has improved considerably, reflecting the settlement with the cartel office and the development of an incentive-based regulatory framework for networks in Germany.

'German' discount to further diminish? RWE's and E.ON's valuation discounts on political concerns are for the most part no longer justified, in our view. Thus, we expect their current 20-30% P/E discounts to narrow to 10-20% in the next 12-18 months.

Companies Featured

Company (Ticker, Price, Price Target)	Upside	Rating
RWE (RWE GR, €89.56, €101)	13%	Overweight
CEZ (CEZ CD, CZK1265, CZK1366)	8%	Equal-weight
E.ON (EOA GR, €127.67, €139)	9%	Equal-weight

Source: Morgan Stanley Research

RWE Especially Attractive versus Sector

	EV/EBITDA		Dividend Yield (%)		
	2008e	2009e	2007e	2008e	2009e
RWE	**6.8**	**6.6**	**4.8**	**4.2**	**4.3**
CEZ	9.4	7.7	2.0	2.7	3.1
E.ON	6.9	6.5	3.1	3.7	4.3
European Ind. Avg.	8.6	8.0	3.8	3.8	4.2

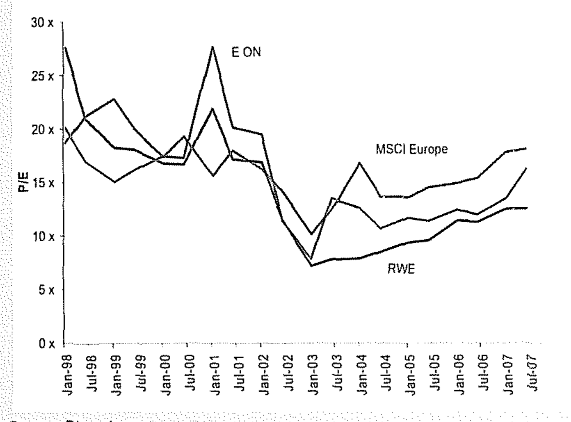
Source: Morgan Stanley Research Estimates

RWE and CEZ Benefit Most from Higher Oil / Power

	Base Case (%)			Scenario + 10% Oil Price			
	Oil US$/bbl	Power €/MWh	NAV	Oil US$/bbl	Power €/MWh	NAV	Chg
CEZ	64	60.4	CK1366	70.4	64	CK1529	**12%**
E.ON	64	60.4	€139	70.4	64	€147	**6%**
RWE	64	60.4	€101	70.4	64	€113	**12%**

Source: Morgan Stanley Research

RWE P/E Trading below E.ON and MSCI Europe



Source: Bloomberg:

Value Rising: Higher Power Prices and German Tax Reform

RWE (Overweight) emerges as our preferred stock versus CEZ and E.ON after upgrading NAVs for all three. Our RWE price target increases by 10% to €101 for 13% upside potential, based on our revised sum-of-the-parts. This contrasts with CEZ (Equal-weight), where we have raised the price target by 19% to CZK1366, but for only 8% upside, and E.ON (NAV up 5%) for 9% upside. The higher increase in our CEZ valuation than either E.ON or RWE is due to CEZ's greater sensitivity to higher power prices, the share buyback and a lower increase in revenue/capital costs.

Resuming on E.ON. We are resuming coverage on E.ON with an Equal-weight rating (price target €139 — 9% implied upside), as we believe that the potential benefits from the positive power price trend and the company's expansion strategy are largely priced in.

Neutral on CEZ. CEZ's share price does not fully reflect a potential further increase in power prices to €60/MWh. Value accretive investments could push CEZ' share price further. However, we take a neutral view on CEZ investment plans in MOL and Russia so far as we do not yet have good visibility on potential acquisition prices.

Value rising: €60/MWh new power price expectation and a lower tax rate. We have upgraded our price targets to take into account our new long-term power price assumptions of €60/MWh (up from €56/MWh) and the likely positive impact of the German tax reform.

Our new long-term power price estimate reflects the break-even value of a new gas fired power plant based on Morgan Stanley's global oil analyst Doug Terreson's new long-term Brent oil price of US$64/bbl (see *Integrated Oil: Raising Oil Price Forecast; Overweight Integrated Oils*, Sept. 5, 2007) and increased investment costs for new power plant technology. The break-even level of a new coal-fired power plant of €60.60/MWh (€55.70/MWh) reflects our new long-term coal price estimate of US$70/t (US$60/t) and increased investment costs for new power plant technology.

Earnings fillip from tax reform partly offset by higher investment. E.ON and RWE will benefit from the reduction of the corporate tax rate from 39% to 30% under Germany's tax reform in 2008. The positive impact of this on our EPS estimates (about +7% for E.ON and about +14% for RWE) is higher than on our new fair value estimates, as our new fair value estimates also take into account the negative impact on the higher costs for new investments.

Exhibit 1

RWE, E.ON: Good value compared to peer group

	P/E			EV/EBITDA			Dividend Yield (%)		
	07e	08e	09e	07e	08e	09e	07e	08e	09e
RWE	15.5	12.2	12.1	7.4	6.8	6.6	4.8	4.2	4.3
E.ON	16.3	13.6	12.0	7.9	6.9	6.5	3.1	3.7	4.3
CEZ	21.7	17.0	12.9	11.0	9.4	7.7	2.0	2.7	3.1
European Ind. Avg.	**21.6**	**17.6**	**15.2**	**9.2**	**8.6**	**8.0**	**3.8**	**3.8**	**4.2**

Source: Company data, Morgan Stanley Research e = Morgan Stanley Research estimates

RWE is among the cheapest utilities stocks in our Western European coverage. For 2007-09e, it trades on a 20-30% P/E discount to the European industry average and we expect this to narrow to about 10-20% in the next 12-18 months (see below). We maintain our Overweight rating on RWE as the shares are already pricing in the potential burden from increasing costs related to the CO2 emissions trading scheme, while the market underestimates the value of rising power prices. We see potential for additional value from creative reinvestment and/or share buybacks.

We expect sentiment on RWE shares to improve with increasing visibility on the company's future strategy with the new CEO Dr. Grossmann having taken the helm on 1 October this year. The disposal of a large part of the company's non-core operations, and details on the related share buyback program should further improve sentiment.

RWE, E.ON: 'German' discount to continue diminishing
The traditional discounts on which E.ON and RWE have traded to their European peers are becoming less valid, in our view. Here are six reasons why.

First, we think the days of a collapse in power prices due to overcapacity can be resigned to history, at least for the medium term, as tight reserve margins should support the positive power price trend towards the break-even level of a new gas fired power plant (€60/MWh). We expect reserve margins to remain tight despite moderate demand growth and increasing pressure for energy efficiency, due to the high age of the existing power plants in Germany and neighboring markets, and due to Germany's nuclear phase-out agreement.

Second, high investment costs discourage new entrants. Several investors (for example, the municipal utility SWB

Bremen) have cancelled their planned power plant investments as costs have increased significantly during the last 2-3 years, due to strong demand and limited capacities at engineering companies such as Alstom, Siemens and Babcock-Hitachi. According to a survey published by Trend Research, investment costs for new coal-fired power plants have nearly doubled during the last three years to €1,500/kW. We have heard of similar amounts in our conversations with power producers.

Exhibit 2

Reserve Margins: Germany and Neighbor Countries

	2007e	2008e	2010e	2015e	2020e
DE (%)	7	8	7	5	1
AT (%)	25	24	27	30	26
BL (%)	7	6	6	-2	-15
NL (%)	8	8	13	6	1
F (%)	9	8	8	5	0
CH (%)	21	21	20	18	16
AT (%)	25	24	27	30	26
CZ (%)	13	13	9	7	4
PL (%)	13	12	11	2	-36
SK (%)	1	0	-5	-16	-24
HU (%)	6	7	2	-26	-75

Source: UCTE estimates

However, established players such as E.ON and RWE are so far sticking to their investment plans, as they have already locked in some of the related costs when the investment decisions were decided on 1-2 years ago. Also, their associated risk appears lower as they can benefit from synergies and more flexibility in the utilization of their power plant portfolios.

Fourth, with the commencement of the German network regulator in 2H 2006, uncertainty on the impact of German network regulation has diminished and should continue to fall as visibility increases on the next regulatory period starting from 2008 and the start of the incentive scheme in 2009. The incentive scheme will provide a more certain framework for Germany's network operators for a period of 5 years.

Fifth, the German cartel office recently dropped its investigation into RWE's pricing strategy of 2005.

Last, while discounts are currently applied to the German utilities – especially RWE – due to concerns that from 2013 CO2 procurement costs will hurt profitability more than some of their European competitors, both RWE and E.ON have strong balance sheets which enable them to invest into renewable energies and less CO2 emission intense operations and/or higher growth regions. This should help to establish profit growth despite the rising burden from the European CO2 emissions trading system, and at the same time help increase balance sheet efficiency.

A 10% increase in the oil price raises NAV for RWE and CEZ by 12%, E.ON by 6%

All three companies' demonstrate sensitivity to oil and power price changes and gearing due to their considerable dependence on power production and strong balance sheets. However, RWE and CEZ benefit most as their power production assets consist mainly of nuclear power and brown coal which have higher cost stability compared to hard coal and gas. In our sensitivity analysis a 10% increase in oil price raises power prices by 6% to €64/MWh, and NAV for RWE and CEZ by 12%, and E.ON by 6%.

However, due to their strong exposure to brown coal-fired power production, RWE and CEZ would suffer slightly more from higher CO2 certificates prices than E.ON, while E.ON and RWE show marginally stronger sensitivity to hard coal prices. E.ON and RWE compared to CEZ are slightly more sensitive to higher hard coal prices: +10% increase in hard coal prices reduces our NAVs by 1-3%.

Exhibit 3

Sensitivity analysis +10% oil price

	Base case (%)			Scenario + 10% Oil price			
	Oil US$/bbl	Power €/MWh	NAV	Oil US$/bbl	Power €/MWh	NAV	Chg
CEZ (CZK)	64	60.4	1366	70.4	64	1529	12%
E.ON (€)	64	60.4	139	70.4	64	147	6%
RWE (€)	64	60.4	101	70.4	64	113	12%

Source: Company data, Morgan Stanley Research estimates

Exhibit 4

Sensitivity analysis +10% CO2 certificate price

	Base case		Scenario + 10% CO2 price		
	CO2/t	NAV	CO2/t	NAV	Chg
CEZ (CZK)	20	1366	22	1309	-4%
E.ON (€)	20	139	22	135	-3%
RWE (€)	20	101	22	95	-6%

Source: Company data, Morgan Stanley Research estimates

Exhibit 5

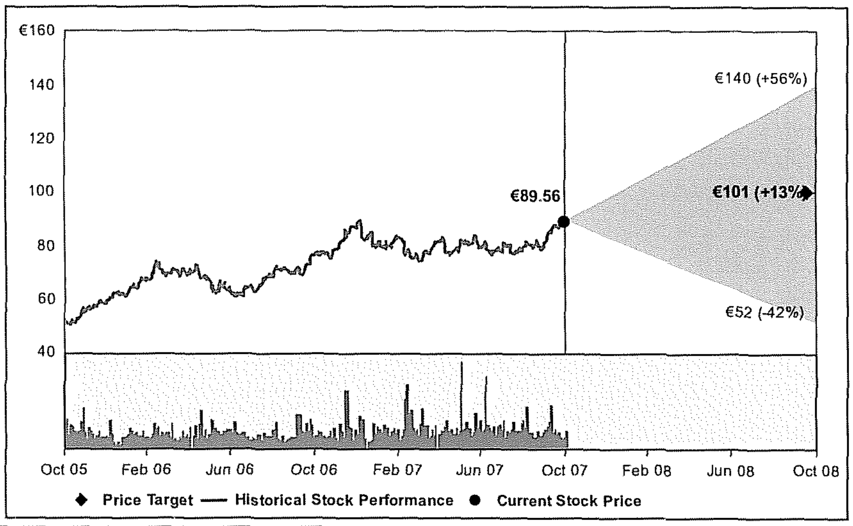
Sensitivity analysis +10% hard coal price

	Base case		Scenario + 10% coal price		
	Coal US$/tonne	NAV	Coal US$/t	NAV	Chg
CEZ (CZK)	70	1366	77	1351	-1%
E.ON (€)	70	139	77	136	-2%
RWE (€)	70	101	77	98	-3%

Source: Company data, Morgan Stanley Research estimates

Risk-Reward Snapshot: RWE (RWEG.DE, €89.56, OW, PT €101)

Regearing and non-core disposal provide upside risk

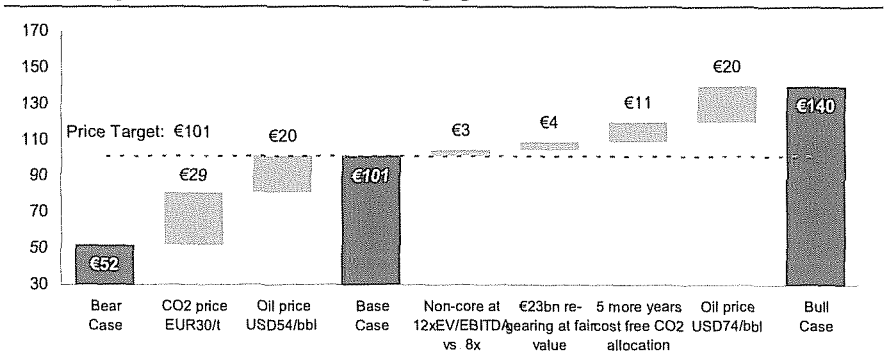


Source: Company data, Morgan Stanley Research

Scenario Summaries

Bull Case €140	Power price of €66/MWh based on US$74/bbl oil price. Five more years of cost-free allocation of CO2 certificates from 2013-2017. €23 billion re-leveraging of balance sheet at fair value. Disposal of non-core operations at 12x 07 EV/EBITDA.
Base Case €101	Power price reaches €60MWh in line with our break-even estimate for a gas- fired power plant based on an oil price of US$64/bbl. CO2 prices stabilize at €20/t and no more cost-free allocation from 2013.
Bear Case €52	Power price of €54.8/MWh in the long term based on US$54/bbl oil price. CO2 prices increase to €30/t and no more cost-free allocation from 2013.

Price target assumes no re-leveraging of RWE's balance sheet



Source: Morgan Stanley Research estimates, FactSet

Why Overweight?

- RWE is among the cheapest European utilities: 2007e P/E of 15.5 is a 28% discount and EV/EBITDA of 7.4x a 19% discount to the industry.
- 13% upside potential to our €101 price target, based on sum-of-the-parts NAV.
- High dividend yield of 4.8% in 2007e and 4.2% in 2008e
- Strong operating profit growth from core business in 2006-11e (+10% CAGR)

Key Value Drivers

- Further closing of the 'German utility' discount with increasing clarity on the energy political environment.
- Our price target would rise by a further 4% from €23 billion expenditure on investments at fair value, as it would increase gearing and lower the cost of capital.
- Our price target would rise by 3% if the disposal of non-core operations took place at 12x 2007 EV/EBITDA compared to the 8x 2007 EV/EBITDA in our assumption.

Potential Catalysts

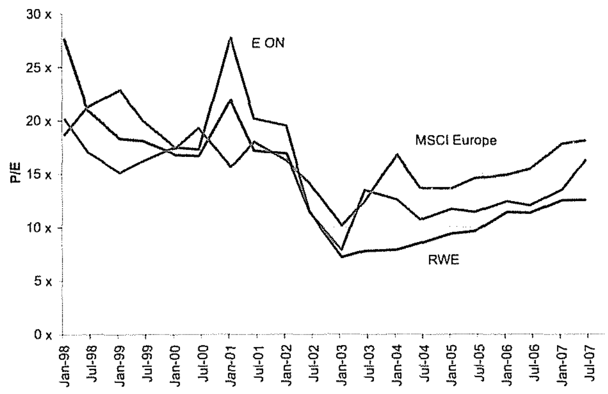
- Disposal of non-core operations.
- Details on the planned share buyback program.
- Increased transparency on the new CEO's strategic ideas. We gained a positive first impression from the new CEO when he presented for the first time to investors on 11 October.
- A more detailed strategy and financial targets is scheduled disseminated to the market on 22 February 2008.

RWE (Overweight): One of the Cheapest Utilities in Western Europe

RWE emerges as our preferred stock after raising NAV to reflect our new commodity outlook and lower German tax. Our price target rises by 10% to €101 for 13% upside potential. This contrasts to CEZ, with only 8% to our CZK1366 price target and to E.ON with 9% upside to our €139 price target.

Substantial discount in the wake of underperformance. RWE is among the cheapest utilities stocks in our Western European coverage. The shares trade on a 28-31% P/E discount to the European industry average (of 21.6x) on 15.5x in 2007e and 12.2x in 2008e, and on a discount of 19% on 7.4x EV/EBITDA in 2007, which widens to 21% on 6.8x EV/EBITDA in 2008.

Exhibit 6
RWE: P/E trading below E.ON and MSCI Europe

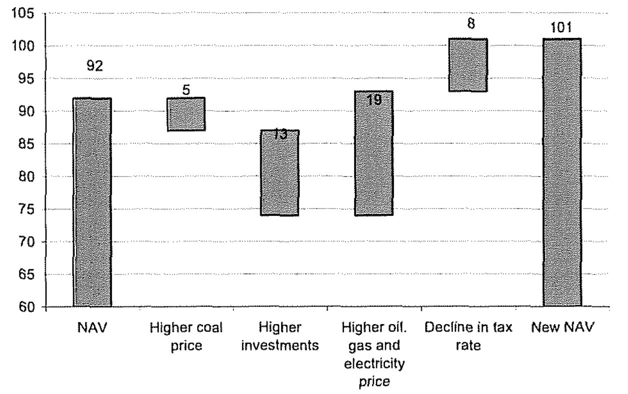


New CEO Dr. Grossman: Reassuring first speech to investors on 11 October

We attended Dr. Grossmann's first address to RWE's investors and analysts on 11 October, and came away reassured on our Overweight stance on the stock. We expect sentiment on RWE shares to improve on increasing visibility on the company's future strategy. Dr. Grossmann inherits a focused energy utility portfolio with, we estimate, scope for about €23 billion re-leveraging (based on maintaining a strong A credit rating). Disposal of non-core operations and details on the related share buyback program should further improve sentiment.

Dr. Grossman highlighted that he is keen to address: 1) the challenge of reducing RWE's CO2 emissions intensity; 2) value accretive reinvestments into higher growth markets; 3) strengthening RWE's competitiveness with more attractive and innovative products; and 4) developing a more entrepreneurial spirit within the organization and improving processes.

Exhibit 7
RWE: New NAV €101 (+10%)



Source: Morgan Stanley Research estimates

Exhibit 8
RWE: New vs. old estimates, 2006-11e

(€mn)	2006	2007e	2008e	2009e	2010e	2011e
EBIT						
New	**6108**	**6662**	**7385**	**7457**	**8852**	**9086**
Old	6106	6598	7467	7269	7760	7691
% Change	0	1	-1	3	14	18
Recurrent net income (RWE definition)						
New	**2468**	**3240**	**4117**	**4157**	**5133**	**5318**
Old	2466	3052	3699	3581	3877	3839
% Change	0	6	11	16	32	39
DPS (€)						
New	**3.50**	**4.30**	**3.80**	**3.85**	**4.55**	**4.70**
Old	3.50	4.30	3.80	3.85	4.00	4.10
% Change	0	0	0	0	14	15
EPS (ModelWare, €)						
New	**4.39**	**5.76**	**7.32**	**7.39**	**9.13**	**9.46**
Old	4.38	5.43	6.58	6.37	6.89	6.83
% Change	0	6	11	16	32	38

e = Morgan Stanley Research estimates Source: Company data, Morgan Stanley Research

Dr. Grossmann also reassured that he will stick to important projects initiated by the former management, such as: 1) disposal of non-core operations in the near future; 2) the execution of the related share buy-back; 3) maintaining the company's payout targets of 70-80% in the year of the non-core asset disposal and 50-60% thereafter; and 4) expanding RWE's upstream and midstream gas operations.

The challenge of CO2 emissions intensity
To reduce RWE's CO2 emissions intensity, Dr. Grossmann plans further expansion into renewable energies, even if some of the projects' payback is longer than for conventional power technology investments. So far, the company has only targeted investments into renewable energies of about €700 million, which appears too low to us if it is to make significant achievements.

Value accretive reinvestments for growth
Dr. Grossmann plans to maintain RWE's financial criteria for external growth projects and the regional focus in general, but seems to take a more open minded view on the topic in general. Regional diversification via M&A deals using RWE's balance sheet strength and / or asset swaps appear an obvious solution to us to increase RWE's market position in foreign core markets and to reduce to some extent the market power concerns in Germany.

While RWE has the balance sheet strength, we assume Dr. Grossmann has the requisite vision required to impress the market with a more detailed presentation on 22 February next year. His international network and entrepreneurial experience should help him to evaluate opportunities abroad and to approach attractive targets successfully. Investments into renewable energies should furthermore help to create a more environmental-friendly image.

Assuming RWE invests €23 billion in new growth projects by the end of 2008, and conducts this releveraging at fair value, the positive effect on the company's cost of capital (-24 basis points) could add €4 per share to our base case NAV estimate.

Innovative products to strengthen RWE's competitive profile
Dr. Grossmann wishes to bring in fresh ideas for innovative products to improve RWE's competitive profile. We believe that his background as the owner and manager of a steel mill not only help him to better understand client needs but also equip him to build relationships with energy intense industries that suffered during last year's rise in power and gas prices.

German tax reform to push net income from 2008; earnings estimates revised after 1H07 results

We marginally revised up our operating earnings expectations for 2007-09 after the release of 1H07 results and significantly upgraded our operating estimates for 2010 and 2011 taking into account our higher power price assumptions and the savings RWE could make on CO2 certificates by the participation in CDM/JI projects.

RWE explained as part of its 1H 2007 results presentation that it aims to utilize its full CDM/JI redemption capacity of about 90m certificates for the period 2008-12. About half of the 90m will stem from own projects.

The reduction of Germany's corporate tax rate from about 39% to 30% as from 2008 significantly increases our net income estimates. However, the positive impact from the German tax reform on our EPS estimates is higher than on our new fair value estimates, as our new fair value estimates also take-into account the negative impact on the higher costs for new investments.

Valuation: We base our fair value estimate for RWE of €101 on a sum-of-the parts using DCF valuations for all of the company's major business units. Our DCF uses a WACC of 6.3% (after-tax) for all the key divisions (10% for RWE DEA) and long-term growth of 2.0% to 2.5%.

Risks: The main risk to our price target is wholesale power prices, as our earnings expectations and price target assume a further increase to €60/MWh (base-load) long-term. We also note the EU's antitrust investigation on RWE's long-distance gas operations, which could lead to court cases and/or a cartel fine.

Exhibit 9

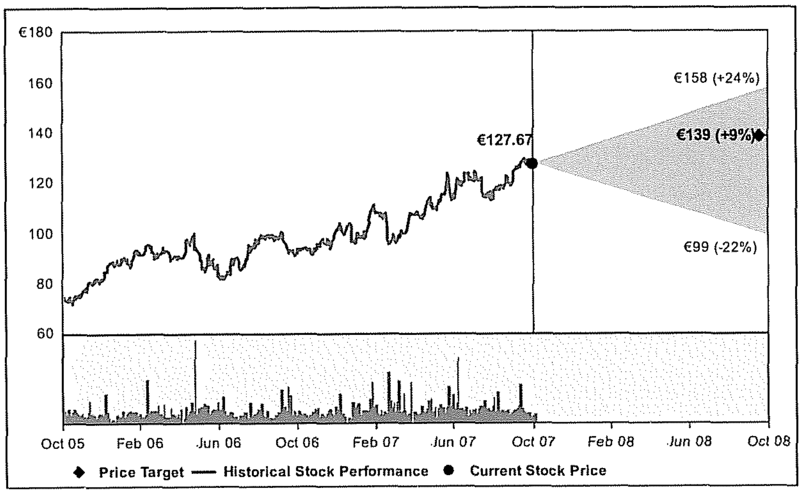
RWE: Sum-of-the-Parts Valuation – NAV €101

				EV/EBITDA		
RWE Division	Value (€m)		Comment on valuation	2007E	2008E	2009E
RWE Power excl. Dea (electricity generation)	33900	DCF	(WACC 6.3% after tax, g:2%)	9.2	8.0	7.9
RWE Dea	3499	DCF	(WACC 10%, after tax)	4.7	4.4	4.1
RWE Energy	25044	DCF	(WACC 6.3% after tax, g:2%)	8.6	8.6	8.0
Npower	5181	DCF	(WACC 6.3% after tax, g:2.5%)	5.8	5.8	5.9
Others (non-core)	5616					
Capitalised holding cost	-576	7.0	xEV/EBITDA07E	7.0	7.0	7.0
Total	72664					
Pension provisions	-3797		Book value as of Dec 2007E incl. CTA			
Nuclear provisions	-8834		Expected book value as of Dec 2007			
Mining provisions	-2548		Expected book value as of Dec 2007			
Net financial position adj.	-2859		Net debt position as of Dec 2007 incl. CTA			
Financial assets	3917		Expected book value as of Dec 2007			
Minorities	-1757		3xP/BV07e			
Total SOTP Value	**56786**					
Number of shares (m)	562.4					
Value per share (€)	**101**					

Source: Company data, Morgan Stanley Research Note: SOTP in contrast to balance sheet includes the effect of RWE's CTA
e = Morgan Stanley Research estimates

Risk-Reward Snapshot: E.ON (EOA €127.67, EW, PT €139)

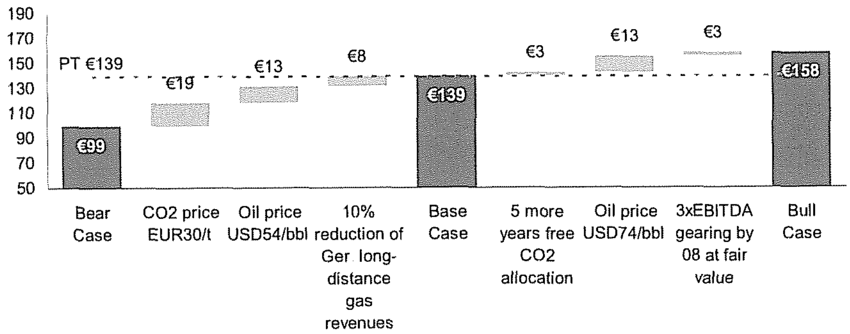
Expansion strategy largely reflected in the price



Scenario Summaries

Bull Case €158	Power price of €66/MWh based on a US$74/bbl oil price. Five more years of cost free allocation of CO2 certificates from 2013-2017. Gearing target of net economic debt equal to 3x EBITDA in 2008 reached without paying premium for growth project acquisitions.
Base Case €139	Power price reaches €60MWh in line with our break-even estimate for a gas-fired power plant based on an oil price of US$64/bbl. CO2 prices stabilize at €20/t and no more cost free allocation as from 2013.
Bear Case €99	Power price of €54.8/MWh in the long term based on US$54/bbl oil price. CO2 prices increase to €30/t and no more cost free allocation as from 2013. 10% lower long-distance gas revenues in Germany.

Our price target takes a neutral view on E.ON's expansion plans



Source: Company data, Morgan Stanley Research

Why Equal-weight?

- Moderate upside potential of 9% to €139 price target.
- Share price has increased by more than 10% following commitment in May this year to releverage the balance sheet via investment and share buybacks.
- Our base case already takes into account the completion of the company's €7 billion share buyback program by the end of 2008.

Key Drivers

- A 10% increase in the oil price could push our price target up a further 6%.
- Re-gearing to the tune of €8 billion re-investment at fair value could push our price target up c.2%.
- Further closing of the 'German utility' discount with increasing clarity on the energy political environment

Potential Catalysts

- Strong quarterly results in 2007 and prospects for about 10% growth in operating results by 2010 (9.6% in CAGR 06-10).
- Dividend growth and dividend yield of 3.7% in 2008e – we expect +16% CAGR dividend growth in 2006-10.
- Updates on the execution of specific investment projects, if perceived value accretive.

Error

An error occurred while processing this page. See the system log for more details.

The Turkish power market is at risk from future supply shortages due to the lack of past investment, low water reservoir levels and strong growth in demand. This could force the Turkish government to allow higher power prices and to speed up the liberalization process.

In 1995-2005, electricity demand grew by 6.5% (CAGR) and we expect further growth at a similar rate by 2020, considering that power consumption per capita in Turkey is only about 25% of the German level.

Demanding price for Russian opportunities

For the Russian power producer OGK-4, E.ON offered US$5.7 billion for a 70% stake (US$3.9 billion for a 47% stake from ROA UES and in a second stage US$1.8 billion for a 23% stake as part of a capital increase). Taking into account OGK-4's net debt position of US$131 million and 2.4GW additional capacity in development, we calculate a purchase price of US$750/kW, which is above prices paid in similar transactions in recent months (Exhibit 12).

E.ON justified the purchase price on the basis of the comparably young asset portfolio of OGK-4 and a comparably high average load factor for the portfolio of 68% in 2006 and with the scope for operating improvements.

In addition, E.ON wishes to benefit from price increases enforced by higher electricity demand (expects 5% growth p.a. by 2012), investment needs and rising gas prices.

Russian power prices, in E.ON's view, will probably increase from the 2006 level of about US$30/MWh at a 20% to 25% rate p.a. to Western European levels by 2012.

Exhibit 12
Prices paid in recent Russian power transactions

Target	Date	Acquirer	Stake post-money	Price Paid ($m)	Implied EV ($m)	Capacity (MW)	EV ($) / kW
			money				
OGK-3	Mar-07	Norilsk Nickel	38%	3121	5274	8497	621
TGK-5	May-07	KES Holding	27%	451	1237	2467	501
TGK-3	May-07	Gazprom	29%	2359	6534	10677	612
OGK-5	Jun-07	Enel	30%	1797	5912	8672	682
OGK-4*	Sep-07	E.On	70%	5700	8274	11030	750
TGK-1	Sep-07	Gazprom	38%	1524	4424	6237	709
OGK-2	Oct-07	Gazprom	12%	650	4499	8695	517
TGK-9	Oct-07	IES	TBC	TBC	1875	3280	572

Source: Company data, Morgan Stanley Research

We are less optimistic on Russian power prices than E.ON in our expectations, assuming about 10% annual growth (CAGR 2006-12e) to US$54/MWh. We therefore believe that E.ON may have overpaid for these assets.

Considering the relatively small deal size of €4.1 billion compared to E.ON's EV of about €107 billion (of which €84 billion is equity), the impact of the potential value destruction appears not that high, based on our NAV estimate.

Iberian and US wind farms to enrich E.ON's renewable energy portfolio ...

E.ON will become the seventh-largest global wind farm company after its planned acquisitions of the Iberian wind farm operator Energi E2 Renovables Ibericas and the US wind farm company Airtricity, recently announced.

The acquisitions fit with E.ON's investment plan to increase its renewable energies portfolio and diminish the CO2 intensity of its group wide power production portfolio.

The purchase prices paid are in the upper range of prices paid in recent wind farm transactions, but above average load factors help justify the prices paid.

Energi E2 Renovables Ibericas will add 260MW capacity plus 560MW development portfolio

E.ON will acquire Energi E2 Renovables Ibericas, a wind farm operator, from the Danish utility Dong Energy at a purchase price of €722 million including €256 million net debt.

The company's portfolio currently comprises 240MW and 20MW generation capacity in Spain and Portugal, and the company plans to expand this capacity by 505MW in Spain and by 55MW in Portugal for €600m. Most of the capacity is wind farms and, to a minor extent, it includes mini-hydro and biomass assets. The purchase price of €2.8 million/MW based on existing capacity of €1.6/MW, including the development portfolio, is in the upper range of prices paid in recent transactions.

When E.ON announced the transaction, the company highlighted the assets' above-average load factors (Spain:

2,450h/a, more than 10% above country average of 2,200h/a; Portugal: 3,200h/a).

Based on E.ON's wind power price expectations of up to €85/MW in Spain and up to €77/MW in Portugal, we calculate a fair value for the wind assets acquired of €1.3 billion in line with the price paid by E.ON including the planned 560MW capacity under development.

Airtricity North will add 214MW capacity plus 2000MW *development portfolio*

E.ON will acquire the wind energy company Airtricity North for US$1.4 billion including US$553 million of net debt.

The company's current capacity exists of 214MW of operating assets and a development pipeline of 2000MW, which should start operations progressively (370MW in Q1-08, 507MW in Q4-08 and >1000MW later). The investments needed for the development pipeline amount to about US$3.5 billion by 2011.

The purchase price is roughly in line with prices paid in recent transactions. We calculate an average purchase price for the total portfolio including the development pipeline/investments of US$2.2m/MW. If we do the calculation only for the existing assets (US$1.4 billion for 214MW) plus the near term available development capacity (US$450 million for 370MW by Q1-08) the price for this capacity amounts to US$3.1m/MW.

Assuming a WACC of 6%, the portfolio's high load factor of 38% and 20-year operational life, we calculate a fair value for these wind farms of US$2.1m/MW.

Valuation: *Our €139 price target for E.ON is based on our fair* value estimate using DCF valuations for all of the company's major business units. Our DCF uses a WACC of 6% and long-term growth of 2.0% to 2.5%.

Risks: The main risk to our price target is wholesale power prices, as our earnings expectations and price target assume a further increase to €60/MWh (base-load) long-term. We also note the potential impact of lower long-distance gas revenues, if the German regulator decides on a cost/and or incentive scheme based regulation of long-distance gas network fees. The EU has launched an investigation into E.ON's long-distance gas operations and it is still unclear whether the EU has found proof of market abuse.

Exhibit 13

E.ON: Sum-of-the-Parts Valuation – NAV €139

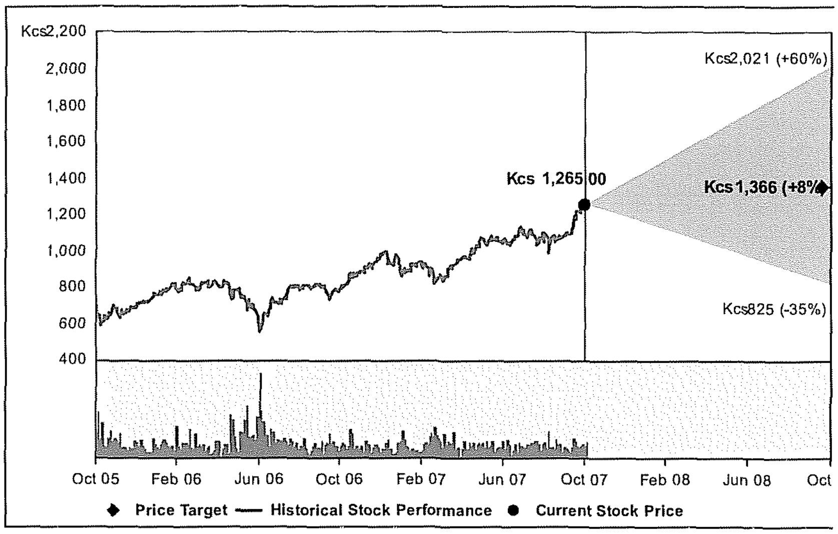
				EV/EBITDA		
E.ON: Division		Value (€m)	Comment on valuation	2007E	2008E	2009E
Central Europe	47,067	DCF	(WACC 6% after tax, g:2%)	8.6	8.1	7.1
Pan European Gas	23,426	DCF	(WACC 6% after tax, g:2%)	10.2	9.4	9.5
UK regulated (%)	3,390	RAV	incl. 12 premium			
UK unregulated	7,652	DCF	(WACC 6% after tax, g:2.5%)	5.0	6.1	5.9
Nordic	11,735	DCF	(WACC 6% after tax, g:2%)	9.9	9.0	8.7
US electricity	6,315	DCF	(WACC 6% after tax, g:2%)	10.8	10.7	10.5
Southern Europe	10,000		As indicated by E.ON			
Capitalized holding cost	-3,160	8.0	x EV/EBITDA07			
Total	106,424					
Pension provisions	-3,885		Expected book value as of Dec. 2007			
Nuclear provisions	-13,646		Expected book value as of Dec. 2007			
Mining provisions	-1,978		Expected book value as of Dec. 2007			
Net cash (debt) E.ON stand alone	-16,144		Expected book value as of Dec. 2007			
Financial assets E.ON excl. long-term securities	21,002		Expected book value as of Dec. 2007			
. of which Gazprom at market value excl. Russ. Tax	10,145					
Minorities E.ON	-7,822		1.5xP/BV 2007			
Total SOTP value	**83,951**					
Number of shares (m)	604					
Value per share (€)	**139**					

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Risk-Reward Snapshot: CEZ (CZK1265, EW, PT CZK1,366)

Power price trend almost priced in

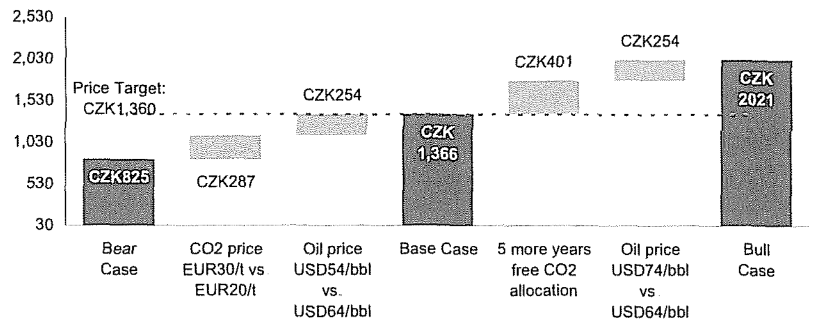


Source: Company data, Morgan Stanley Research

Scenario Summaries

Bull Case CZK2021	Power price of €66/MWh based on US$74/bbl oil price. Five more years of cost free allocation of CO2 certificates from 2013-2017.
Base Case CZK1,366	Power price reaches €52/MWh in 2008 and €60MWh from 2009 in the Czech Republic (oil price US$64/bbl). Poland and Bulgaria price convergence takes place in a longer timeframe. CO2 prices stabilize at €20/t and no more cost-free allocation from 2013.
Bear Case CZK825	Power price might increase to no more than €54.8/MWh in the long term based on US$54/bbl oil price. CO2 prices increase to €30/t and no more cost-free allocation from 2013.

NAV Scenario Analysis



Source: FactSet, Morgan Stanley Research estimates

Why Equal-weight?

- Upside potential of just 8% to CZK1366 price target.
- CEZ shares trade roughly in line with other European power producers comparing P/E and EV/EBITDA ratios for 2008-09.
- Positive impact of the increasing power price trend is largely priced in.

Key Drivers

- Releveraging effect from potential value accretive acquisitions of CZK50 billion at fair value could push our price target up by 3%.
- The company's low gearing would allow for higher payout and/or additional share buyback programs.
- Should the Czech government decide on cost-free allocation of CO2 certificates from 2013-17, this would push up our price target by 29%. Such a scenario is more likely for CEZ than for the German competitors due to the country's weaker economy.
- CEZ benefits most from commodity price driven power price increases, as the company's production portfolio has no exposure to oil and gas fired power production and very limited exposure to hard coal fired power production assets.

Potential Catalysts

- Increasing visibility on the earnings impact of the positive power price trend in CEZ' core regions.
- News of progress on CEZ's share buyback program.
- Potential announcement of a higher dividend payout ratio in light of its high cash flow.

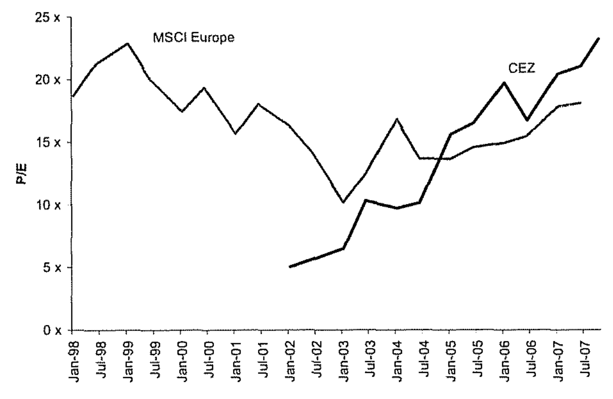
CEZ (Equal-weight): Power Price Play with Growth Ambitions

Multiples in line with European peer group. We rate CEZ Equal-weight as there is just 9% upside potential to our new price target of CZK1366, which we increase by 19% from CZK1150 on an improved commodity outlook. The extent of the increase in the price target is higher than for E.ON (5%) or RWE (10%) given its greater sensitivity to higher power prices, and due to the benefit of the share buyback and the lower increase in revenue/capital costs. CEZ shares trade roughly in line with other European power producers on 2008-09e P/E and EV/EBITDA.

Power price trend priced in… CEZ benefits most from commodity-price-driven power price increases, as the company's production portfolio has no exposure to oil and gas fired power production and very limited exposure to hard coal fired power production assets. We believe, however, that the positive impact of the increasing power price trend is largely reflected in the share price.

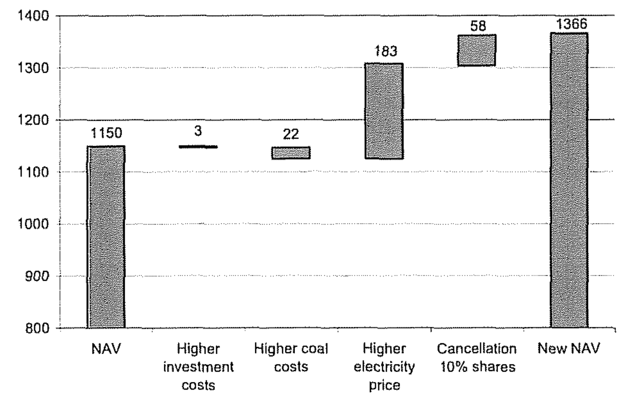
… but upside potential exists. Value accretive acquisitions given its low gearing (of about 10%) would allow for higher payments to shareholders, could improve the company's balance sheet structure and create additional upside in CEZ' share price, in our view. Furthermore, should the Czech government decide for cost-free allocation of CO2 certificates from 2013-17, this would push up our price target by 29%. Such a scenario is more likely for CEZ than for the German competitors due to the country's weaker economy.

Exhibit 14
CEZ Trades at P/E Premium to MSCI Europe



Source: Bloomberg

Exhibit 15
CEZ: New NAV CZK1366 (+19%)



Source: Morgan Stanley Research estimates

Exhibit 16
CEZ: New vs. old estimates, 2006-11e

(CZK mn)	2006	2007e	2008e	2009e	2010e	2011e
EBIT						
New	**40064**	**49207**	**60002**	**74750**	**75693**	**76057**
Old	40064	49207	60017	68037	68952	69329
%Change	0	0	0	10	10	10
Recurrent Net Income						
New	**27697**	**33557**	**41012**	**52067**	**52942**	**53484**
Old	27697	33557	41023	47144	47998	48549
%Change	0	0	0	10	10	10
DPS (CZK)						
New	**15**	**25**	**35**	**40**	**40**	**40**
Old	15	25	35	40	40	40
%Change	0	0	0	0	0	0
EPS (ModelWare, CZK)						
New	**46.95**	**58.26**	**74.87**	**97.69**	**99.33**	**100.04**
Old	46.95	58.26	74.89	88.45	90.05	91.09
%Change	0	0	0	10	10	10

Source: Company data, Morgan Stanley Research e = Morgan Stanley Research estimates

Investment plans still lack visibility. We like the strong visibility on earnings increases related to the positive power price trend and management's shareholder-value-friendly approach. However, we take a neutral view on CEZ investment plans in MOL and Russia so far as we do not yet have good visibility on potential acquisition prices. That said, we realize CEZ's share price does not fully reflect a potential further increase in power prices to €60/MWh, and we see 8% upside potential.

Recent investment ideas could add more than CZK50 billion of debt to CEZ' balance sheet and more than double CEZ' net debt position by the end of 2008. Assuming CEZ pays fair value for the assets the gearing effect could reduce CEZ' cost of capital by 11 basis points to 6.79%, not taking into account the additional risk from exposure to Russia. The positive impact on our NAV estimate would amount to CZK39 per share (+3%). As we expect the up to 10% stake in MOL to be a temporary investment only, we treat it as near cash and neutral to CEZ' gearing.

Exhibit 17

CEZ: Potential value of recent investment ideas (€m)

Potential Value of Recent investment ideas (€m)	
600MW Russian CCGT	345
TGK-4	1120
50% in 800MW Hungarian CCGT	230
50% in 800MW Slovakian CCGT	230
Total €m	1925

Source: Company data, Morgan Stanley Research

Higher power prices raise earnings by 10% from 2009

We upgraded our earnings forecasts from 2009 to take into account our higher power price estimates for CEZ. Higher fuel and investment costs have a marginal negative impact on our estimates. CEZ benefits from the progressive increase in power prices to the new-entrant level of €60/MWh. We expect the €60/MWh price level to be reached in 2009 in the Czech Republic, the largest contributor to CEZ' earnings. In Bulgaria and Poland, we expect this price level from 2012. Bulgarian and Polish wholesale power prices are not yet fully liberalized in contrast to the wholesale power price in the Czech Republic.

Russia – Strategic fit

CEZ plans to enter the Russian market via the construction of a 600MW gas fired heat and power plant in Moscow and eventually the participation in the privatization of the Russian power producer TGK-4. The projects are not yet part of our earnings estimates and valuation as we do not yet have visibility on the conditions/terms.

TGK-4 has a production capacity of 3.3 GW. In 2006, the company produced about 8.2GWh electricity. Most of TGK-4's production capacity consists of gas-fired power plant.

The potential value creation for CEZ from the acquisition will depend on the purchase price and potential operational efficiency gains CEZ might be able to achieve.

Morgan Stanley & Co. Limited, an affiliate of Morgan Stanley, is acting as financial advisor to MOL in connection with the proposed offer announced by OMV AG on 25th September 2007.

In accordance with its general policy, Morgan Stanley currently expresses no rating or price target on MOL or OMV AG. The report and the information herein are not intended to serve as an endorsement of the proposed transaction.

This report was prepared solely upon information generally available to the public. Morgan Stanley has not verified the accuracy or completeness of such information. No representation is made that it is accurate and complete. This report is not a recommendation or an offer to buy or sell the securities mentioned. Please refer to the notes at the end of this report.

For the power plant project in Moscow, CEZ negotiated with the City of Moscow to compensate it for differences between the market and the state-controlled prices. This should limit the risk on the project's profitability. For the power plant, we expect a total investment volume of €345 million.

Temporary take-over protection for MOL – entry to the Slovakian and Hungarian power market

CEZ is in negotiations with the Hungarian oil and gas company MOL for two joint venture projects to build a new gas fired power plant in Hungary and Slovakia. As part of the transaction CEZ has agreed to buy up to 10% of MOL shares. From MOL's perspective, this could help prevent a potential take-over of MOL by its Austrian competitor OMV. A 10% stake in MOL would account for about €1.1 billion at today's share price of €111.74 per share (HUF28300). OMV recently offered HUF32000 per MOL share for at least 50% of MOL's voting rights.

The details of the transaction are not yet fully determined. Press articles speculate on two gas-fired power plants of 800MW capacity – one in Hungary and one in Slovakia, on which CEZ has confirmed it has agreed to pursue cooperation in principle. Based on our long-term oil price estimate of US$64/bbl we calculate that the new CCGT power plants need a long-term power price of about €60/MWh to break even, including full cost of CO2 at €20/t and 9% ROCE.

From a strategic point of view, the investment would make sense for CEZ considering its plans to expand its power production capacity in Central and Eastern Europe, where reserve margins are tightening and power prices already reached levels above the Czech and German level.

Exhibit 18
Reserve margins in Hungary and Slovakia

Reserve margin	2007e	2008e	2010e	2015e	2020e
SK (%)	1	0	-5	-16	-24
HU (%)	6	7	2	-26	-75

Source: UCTE

The cooperation with MOL will help to ensure the supply of gas for the power stations. MOL will also probably benefit from the plant's proximity to MOL's refinery operations. We assume the total investment volume for the two gas-fired power plants will to amount to about €900m.

Vietnam not a core region. At our recent utilities summit, CEZ clearly stated that Vietnam is not a core region. The company may, however, see some opportunities for its power plant engineering subsidiary in the region, which is running short of capacity.

We base our fair value for CEZ (CZK1,366 per share) on a sum-of-the-parts using DCF valuations for all of the company's major business units. Our DCF uses a WACC of 6.9% (after-tax) and long-term growth of 2.5%.

Risks: The main risk to our price target is wholesale power prices, as our earnings expectations and price target assume a further increase to €60/MWh (base-load) long-term. Even though management is confident that the revaluation of its distribution assets will be recognized in the regulated tariff over the next few years, there is some risk that not all of the entire value increase can be passed on.

Exhibit 19
CEZ: Sum-of-the-Parts Valuation – NAV CZK1366

					EV/EBITDA		
CZKm	SOP	% of total		Comment	2007E	2008E	2009E
Czech power production and trading	594,348	73%	DCF	(WACC6.9 after tax, g:2.5%)	12	10	8
Czech distribution and supply	100,229	12%	DCF	(WACC6.9 after tax, g:2.5%)	11	11	10
Czech mining	30,271	4%	DCF	(WACC6.9 after tax, g:2.5%)	7	7	7
Polish power production	12,474	2%	DCF	(WACC6.9 after tax, g:2.5%)	8	7	7
Bulgarian power production	21,113	3%	DCF	(WACC6.9 after tax, g:2.5%)	37	24	16
Bulgarian distribution	16,815	2%	DCF	(WACC6.9 after tax, g:2.5%)	7	7	7
Romanian distribution	13,262	2%	DCF	(WACC6.9 after tax, g:2.5%)	7	7	7
Others	26,960	3%		8xEV/EBITDA07			
Total EV (%)	815,472	100					
Financial assets	13,707			Expected BV end 2008			
Net financial position	-41,712			Expected BV end 2008			
Nuclear provisions	-36,683			Expected BV end 2008			
Mining provisions	-7,175			Expected BV end 2008			
Minorities	-15,333			Expected BV end 2008			
SOTP value	**728,277**						
Number of shares (m)	533						
SOP value per share (CZK)	**1,366**						

e = Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

Exhibit 20

European Utilities: Valuation Comparison, 2006-2009e

Morgan Stanley — Pan European Utilities Team — October 12, 2007 — Utilities Sector Valuation

Country	Company	Rating	Price Target	Price (local) 11-Oct-07	Upside to PT (%)	P / E (ModelWare) 2006FY	2007FY	2008FY	2009FY	EV / EBITDA 2006FY	2007FY	2008FY	2009FY	Dividend Yield (%) 2006FY	2007FY	2008FY	2009FY	FCF Yield (%) 2006FY	2007FY	2008FY	2009FY
Integrated Utilities																					
UK	Scottish & Southern	E	1450	1443	0.5	16.1	15.1	15.2	13.1	10.5	9.9	9.8	8.7	3.5	3.8	4.1	4.5	6.1	6.7	6.6	7.4
France	EDF	O	60.0	76.6	(21.7)	30.6	26.0	20.7	17.9	11.8	11.0	9.6	8.7	1.3	1.6	2.1	2.5	5.3	5.6	6.6	6.8
	Suez	++	++	40.9	NA	22.6	18.4	16.2	14.1	9.3	8.4	7.7	7.0	2.8	3.1	3.4	3.6	2.8	5.2	6.3	7.3
Germany	E.ON	E	139.0	127.7	8.9	9.9	16.3	13.6	12.0	6.2	7.9	6.9	6.5	3.3	3.1	3.7	4.3	4.4	3.2	6.0	7.1
	RWE	O	101.0	89.6	12.8	19.0	15.5	12.2	12.1	8.0	7.4	6.8	6.6	4.2	4.8	4.2	4.3	3.4	5.0	6.3	6.5
Greece	PPC	U	13.0	21.5	(39.5)	199.4	129.9	58.4	21.4	11.1	10.9	10.0	7.8	0.8	0.5	1.2	3.3	5.8	3.2	4.0	6.9
Italy	ACEA	U	11.00	15.51	(29.1)	21.2	24.7	18.9	18.1	9.6	9.8	8.5	8.3	3.7	3.7	3.8	4.0	(5.2)	2.1	(0.5)	1.2
	AEM	O	3.30	2.78	18.7	15.1	20.8	16.7	14.5	9.4	8.6	8.1	7.2	2.8	2.7	2.9	3.0	7.4	14.6	2.6	8.7
	ASM Brescia	O	5.40	4.64	16.4	13.5	18.9	20.3	16.5	8.6	9.8	9.2	8.6	3.7	3.6	2.9	2.7	(0.2)	(4.4)	(2.9)	(1.1)
	Edison	O	2.60	2.46	5.8	13.6	27.7	22.3	19.7	8.4	9.6	8.9	8.3	2.3	2.0	2.2	2.5	2.2	5.3	5.1	3.8
	Enel	++	++	7.98	NA	15.9	12.5	12.4	11.9	7.4	7.8	7.2	7.0	6.3	6.3	6.5	6.7	9.8	5.4	6.1	5.6
	Iride	E	2.90	2.71	7.1	25.9	20.5	18.8	17.7	10.4	10.1	8.9	8.5	2.4	2.4	2.7	3.0	(9.5)	(6.0)	(2.4)	(2.5)
Portugal	EDP	O	4.50	4.13	9.0	14.8	16.4	14.7	11.9	10.6	9.4	8.9	7.7	2.8	2.9	3.2	3.6	12.0	5.9	8.9	13.7
Spain	Endesa	++	++	40.1	NA	16.7	18.2	18.8	17.4	9.0	8.9	8.6	8.2	4.4	3.7	3.6	3.6	6.2	5.7	5.7	5.8
	Iberdrola	NA	NA	42.9	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
	Union Fenosa	U	33.5	40.4	(17.1)	18.1	16.3	16.8	15.1	8.6	8.5	8.7	8.1	2.8	3.2	3.2	3.7	6.4	8.5	6.6	7.3
Average					**(2.4)**	**30.2**	**26.5**	**19.7**	**15.6**	**9.3**	**9.2**	**8.5**	**7.8**	**3.1**	**3.2**	**3.3**	**3.7**	**3.8**	**4.4**	**4.3**	**5.6**
Infrastructure Cos.																					
UK	Kelda	NA -V	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
	National Grid Plc	O	850	733	16.0	16.7	13.0	10.9	10.3	10.4	9.2	8.3	8.0	3.6	4.7	5.2	5.7	(0.4)	(0.1)	3.9	9.1
	Northumbrian WG	O	370	312	18.8	15.3	13.5	13.2	12.9	11.0	10.2	10.1	9.9	3.6	3.8	4.0	4.2	(3.7)	1.1	2.4	3.8
	Pennon	E	620	608	2.0	22.6	21.3	21.7	22.6	11.0	9.9	9.8	9.6	3.0	3.2	3.3	3.5	1.4	5.0	5.6	4.6
	Severn Trent	E	1570	1450	8.3	21.9	17.2	14.7	13.2	12.7	12.4	11.6	10.9	4.2	4.4	4.7	4.9	3.4	0.8	1.7	0.3
	United Utilities	U	675	759	(11.1)	17.7	16.7	14.7	13.5	10.1	10.0	9.6	9.0	5.9	6.1	6.2	6.4	4.6	1.5	2.9	6.9
	Biffa	E -V	295	285	3.5	19.0	19.8	17.2	14.8	10.3	8.1	7.4	6.7	1.8	2.3	2.6	3.0	1.7	4.8	6.6	7.3
France	Veolia Environnemei	O	64.0	56.5	13.2	28.8	26.5	21.8	18.8	10.2	9.6	8.3	7.5	1.8	2.1	2.5	2.7	7.0	3.6	4.5	5.7
Italy	Snam Rete Gas	E	4.35	4.42	(1.5)	18.8	19.2	17.9	17.1	9.5	9.4	9.0	9.0	4.4	4.8	5.2	5.2	0.6	7.0	8.6	9.3
	Terna	O	2.90	2.58	12.5	14.0	16.8	17.0	16.1	8.3	8.4	8.6	8.4	5.4	5.6	5.8	5.9	11.3	4.7	5.7	5.3
Spain	Enagas	O	20.0	18.3	9.5	19.4	18.2	15.5	13.4	10.5	10.6	9.7	8.8	2.7	3.0	3.9	4.5	5.7	7.4	8.9	10.6
	Red Electrica	U	31.0	34.2	(9.4)	22.6	20.1	17.4	15.9	10.8	10.1	9.3	8.7	2.9	3.1	3.6	4.0	15.3	9.4	10.0	11.1
UK Average					**6.3**	**18.9**	**16.9**	**15.4**	**14.5**	**10.9**	**10.0**	**9.5**	**9.0**	**3.7**	**4.1**	**4.3**	**4.6**	**1.1**	**2.2**	**3.8**	**5.4**
Europe Average					**4.9**	**20.7**	**20.1**	**17.9**	**16.2**	**9.9**	**9.6**	**9.0**	**8.5**	**3.4**	**3.7**	**4.2**	**4.5**	**8.0**	**6.4**	**7.5**	**8.4**
Average					**5.6**	**19.7**	**18.4**	**16.6**	**15.3**	**10.4**	**9.8**	**9.3**	**8.8**	**3.6**	**3.9**	**4.3**	**4.6**	**4.3**	**4.1**	**5.5**	**6.7**
Gencos																					
UK	British Energy	U -V	360	545	(33.9)	26.0	15.3	15.1	13.5	4.4	3.8	3.9	3.4	6.7	5.4	3.6	3.8	22.5	5.9	4.4	9.4
	Drax	E	667	741	(9.9)	8.0	7.2	7.1	7.7	5.1	5.6	6.4	7.5	17.7	15.1	10.4	13.5	14.6	10.3	13.3	12.8
	International Power	O	515	429	20.1	17.1	15.2	13.9	13.2	9.0	8.0	7.9	7.7	1.2	1.8	2.4	2.9	2.8	6.1	4.7	4.9
Czech Rep	CEZ	E	1366	1275	7.1	20.4	21.9	17.0	13.1	9.6	11.0	9.4	7.7	1.6	2.0	2.7	3.1	5.6	4.7	6.3	8.7
Finland	Fortum	E -V	24.0	23.6	1.8	18.2	19.6	17.0	15.3	12.0	12.2	11.0	10.1	5.2	5.4	3.4	4.5	3.8	6.5	5.7	6.4
Average					**(2.9)**	**17.9**	**15.8**	**14.0**	**12.6**	**8.0**	**8.1**	**7.7**	**7.3**	**6.5**	**6.0**	**4.5**	**5.6**	**9.8**	**6.7**	**6.9**	**8.4**
Gas Companies																					
UK	Centrica	U	355.0	379.5	(6.5)	16.8	14.7	15.5	16.6	7.9	7.4	7.4	7.6	3.1	3.1	3.2	3.4	(6.8)	8.3	7.9	7.4
France	Gaz de France	++	++	35.8	NA	18.1	15.7	15.6	15.5	8.6	7.6	7.3	7.0	1.7	2.0	2.4	2.9	4.4	8.3	8.8	8.9
Spain	Gas Natural	O	40.0	44.0	(9.2)	19.1	24.6	20.6	18.5	8.8	11.2	9.6	8.8	3.3	2.2	2.7	3.0	12.2	7.2	8.1	8.8
Average					**(7.8)**	**18.0**	**18.4**	**17.2**	**16.9**	**8.4**	**8.7**	**8.1**	**7.8**	**2.7**	**2.4**	**2.8**	**3.1**	**3.3**	**7.9**	**8.3**	**8.4**
Industry Average		**Cautious**			**0.1**	**23.9**	**21.6**	**17.6**	**15.2**	**9.4**	**9.2**	**8.6**	**8.0**	**3.7**	**3.8**	**3.8**	**4.2**	**4.8**	**5.0**	**5.4**	**6.6**

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Appendix: Energy Political Environment

Relief on the Cartel office's Power Price investigation

German Cartel Office dropped its case against RWE

The German Cartel Office agreed with RWE to drop its case against the company's pricing strategy in 2005 in return for RWE's proposal to auction 1.6GW annual capacity (about 4% of RWE's German production capacity) to industrial clients for the limited period of time of 2009-12.

A positive sign for the utilities industry

We consider the German Cartel Office's decision to drop its case important for the sentiment on German utilities and for the European power market in general, as the Cartel Offices case let to concerns about re-regulation of wholesale power prices in Germany.

Our impression is that the Cartel Office realized that its argument that RWE charged industrial customers in 2005 too much for CO2 certificates was not sufficiently robust.

Industrial customers keep complaining

We spoke with the association of industrial energy consumers (VIK) about the compromise the cartel office reached with RWE and the VIK emphasized that the proposed capacity auction is not at all the solution they were targeting.

The VIK argues that prices achieved in the auction will approach EEX prices despite the low start price mentioned in the agreement and that there will only be a marginal benefit for industrial customers participating in the auctions.

The agreement foresees as a minimum price the cost of production for a virtual written-down brown coal/hard coal power plant and compensation for cost-free CO2 allocations received.

Our impression is that the VIK is lobbying for a price discount to its members similar to the discounts French industrial customers receive from EdF. However, we think it is very unlikely that the VIK will manage to achieve this in Germany. The EU critically watches market intervention and the German state – in contrast to the French in EdF – has no majority shareholding in RWE or E.ON.

Remaining uncertainties concentrate on networks

Long-distance gas network revenues at some risk

Our recent conversation with the German network regulator (BNA) confirmed that the regulator plans to take a decision on whether long-distance gas networks should remain exempt from cost-based regulation by the end of this year. The German regulator wants to decide on the issue depending on its conclusion whether there is enough competition among long-distance gas network operators. The association of industrial energy consumers (VIK) has been lobbying for cost-based regulation on the long-distance gas tariffs since years arguing that there is not enough competition in the network, while the gas companies state the contrast. The regulator delayed its decision several times meanwhile and the case seems, even to the regulator, not very clear. We see a 50% chance for a decision towards cost based regulation of long-distance gas tariffs as from next year.

So far, long-distance gas networks are exempt from cost-based network fee regulation. In case the regulator decides on cost-based regulation of long-distance gas networks, we see the risk of network fee cuts. RWE would suffer only marginally from this, due to its limited exposure to long-distance gas operations in Germany, while E.ON shows higher exposure via E.ON Ruhrgas.

We calculate that a 10% cut in long-distance gas network related revenues, would lower E.ON's NAV by about 5%.

Moderate cuts in distribution and electricity transmission tariffs expected as from 2008

By the end of this year/beginning next year the network regulator will announce the network fee approvals for the second and last year of cost based network fee regulation of electricity and gas distribution and electricity transmission networks.

These fees will be valid for 2008 and will set the basis for the following incentive scheme based regulatory period 2009-13.

We expect network fee reductions of 5% for 2008 on average. For the following years, we expect annual cuts of 1.25% in line with the regulator's proposed general efficiency targets.

Ownership unbundling – we see limited impact on companies' valuations

Against wishes of the German and French governments, the EU wants to enforce ownership unbundling of Germany's transmission networks arguing that this is the only way to ensure fair network access and lower energy prices.

Alternatively, the EU suggests that vertically integrated companies should have their transmission networks managed by an independent network operator.

We believe that the EU's argument overlooks that the German regulator controls network fees and fair network access. Furthermore, it ignores that the German government this year established a new law that forces network operators to give new power plant operators preferred access to the network, even if it is at the cost of the network operator's own power plants, in case of bottlenecks.

Even the German network regulator and the new head of the German cartel office stated that they consider the EU's claims for ownership unbundling not justified.

We believe that it will take at least one or two more years until the German companies could be forced to sell or spin off their network assets should the EU insist on this idea.

Considering the attractiveness of the operations for infrastructure funds or private equity investors, we are not concerned about the value the companies could achieve should they dispose of their transmission networks. While selling the assets today would mean even stronger balance sheets for E.ON and RWE there are currently limited obvious reinvestment opportunities, in our view.

Financial Models for E.ON, RWE, CEZ

Exhibit 21

E.ON: Cash Flow Statement, 2006-11e

Y/E Dec 31 (€ million)	2006	2007e	2008e	2009e	2010e	2011e
Net income before minorities	5,456	7,210	6,450	7,100	7,680	7,610
Depreciation and amortization	3,751	2,482	3,404	3,541	3,770	3,994
Losses (gains) from disposals	(829)	(1,215)	-	-	-	-
Other non-cash items	(1,693)	-	-	-	-	-
Changes in deferred taxes	-	-	-	-	-	-
Changes in provisions	1,800	-	-	-	-	-
Changes in working capital	(1,291)	-	-	-	-	-
Operating cash flow	**7,194**	**8,477**	**9,854**	**10,641**	**11,450**	**11,604**
Underlying	-	-	-	-	-	-
Capital expenditure	(4,083)	(14,935)	(7,042)	(7,726)	(6,142)	(5,506)
Investments/acquisitions	(1,078)	-	-	-	-	-
Sales proceeds	3,954	-	-	-	-	-
Changes in LT securities	(771)	-	-	-	-	-
Other	(2,523)	-	-	-	-	-
Investing cash flow	**(4,501)**	**(14,935)**	**(7,042)**	**(7,726)**	**(6,142)**	**(5,506)**
Free cash flow	2,693	(6,458)	2,812	2,915	5,308	6,098
. Before growth investment and disposal proceeds etc.	3,111	(6,458)	2,812	2,915	5,308	6,098
Capital increases	-	-	-	-	-	-
Share buybacks	29	(7,000)	-	-	-	-
Dividends to:						
- E.ON shareholders	(4,614)	(2,164)	(2,490)	(2,795)	(3,127)	(3,389)
- Minority interests	(242)	(254)	(267)	(280)	(294)	(309)
Net movement on financial debt	(1,022)	17,000	-	-	-	-
Financing cash flow	**(5,849)**	**7,582**	**(2,756)**	**(3,075)**	**(3,421)**	**(3,697)**
Net cash movement	(3,156)	1,124	55	(161)	1,887	2,401
Net cash (debt)	(268)	(16,144)	(16,089)	(16,249)	(14,363)	(11,962)
Operating CF per share (€)	**12.9**	**13.1**	**15.8**	**17.6**	**19.0**	**19.2**

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 22

E.ON: Profit and Loss Account, 2006-11e

Y/E Dec 31 (€ million)	2006	2007e	2008e	2009e	2010e	2011e
Revenues	**67,759**	**66,602**	**74,200**	**76,228**	**78,186**	**78,796**
Central Europe	28,380	29,295	31,741	34,070	35,468	35,777
Pan-European Gas	24,987	20,363	22,136	21,904	21,680	21,465
UK	12,569	12,986	12,669	12,547	12,298	12,470
Nordic	3,204	3,710	4,005	4,063	4,276	4,276
US Midwest	1,947	1,802	1,803	1,804	1,976	1,977
Southern Europe			3,641	3,886	4,668	4,724
Other	(3,328)	(1,555)	(1,794)	(2,045)	(2,180)	(1,893)
EBITDA (incl. equity income)	**11,353**	**12,090**	**13,578**	**14,839**	**15,840**	**15,914**
Central Europe	5,484	5,846	5,846	6,966	7,520	7,482
Pan-European Gas	2,839	2,861	3,070	3,159	3,168	3,180
UK	1,790	2,015	1,765	1,797	1,700	1,734
Nordic	992	1,181	1,310	1,344	1,469	1,469
US Midwest	590	583	591	600	609	618
Southern Europe			1,391	1,368	1,769	1,826
Other	(342)	(395)	(395)	(395)	(395)	(395)
Adj. EBIT (incl. equity income)	**8,150**	**9,137**	**10,461**	**11,299**	**12,070**	**11,919**
Central Europe	4,168	4,530	4,782	5,533	5,924	5,683
Pan-European Gas	2,106	2,370	2,579	2,668	2,677	2,689
UK	1,229	1,454	1,165	1,172	1,056	1,076
Nordic	619	804	929	960	1,081	1,077
US Midwest	391	396	402	408	414	420
Southern Europe			1,020	975	1,334	1,391
Other	(363)	(416)	(416)	(416)	(416)	(416)
Non-operating result	(1,936)	1,686	-	-	-	-
Gains on disposals	1,205	1,215	-	-	-	-
Restructuring	-	-	-	-	-	-
Goodwill amortization	(374)	-	-	-	-	-
Other non-operating result	(2,767)	471	-	-	-	-
Financial earnings	(1,081)	(991)	(1,653)	(1,641)	(1,616)	(1,591)
Net financial interest	(163)	(206)	(868)	(856)	(831)	(806)
Interest accretion to provisions	(913)	(913)	(913)	(913)	(913)	(913)
Other financial result	(5)	128	128	128	128	128
Income before tax	5,133	9,832	8,808	9,658	10,455	10,329
Tax	323	(2,529)	(2,358)	(2,558)	(2,774)	(2,719)
Income after Tax	5,456	7,303	6,450	7,100	7,680	7,610
Minority interest	(526)	(552)	(589)	(656)	(688)	(670)
Net income from continued operations	**4,930**	**6,751**	**5,861**	**6,444**	**6,992**	**6,940**
Income from discontinued operations	127	(93)	-	-	-	-
Net income (reported)	5,057	6,658	5,861	6,444	6,992	6,940
% change	(32)	32	(12)	10	9	(1)
EPS (reported continued operations) (€)	7.48	10.45	9.38	10.68	11.58	11.50
EPS (recurrent) (€)	6.66	7.84	9.38	10.68	11.58	11.50
EPS (ModelWare) (€)	**10.42**	**7.84**	**9.38**	**10.68**	**11.58**	**11.50**
DPS (€)	**3.35**	**4.00**	**4.70**	**5.50**	**6.00**	**6.00**
Payout ratio (recurrent) (%)	50	51	50	52	52	52

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 23

E.ON: Balance Sheet, 2006-11e

As of Dec 31 (€ million)	2006	2007e	2008e	2009e	2010e	2011e
Cost	102,334	117,269	124,311	132,037	138,179	143,685
Acc. Depreciation	(55,873)	(57,611)	(61,015)	(64,555)	(68,325)	(72,319)
Depreciable fixed assets	46,461	59,658	63,296	67,482	69,854	71,366
Cost	15,407	15,407	15,407	15,407	15,407	15,407
Acc. Depreciation	(283)	(283)	(283)	(283)	(283)	(283)
Goodwill	15,124	15,124	15,124	15,124	15,124	15,124
Cost	10,980	10,980	10,980	10,980	10,980	10,980
Acc. Depreciation	10,378	10,378	10,378	10,378	10,378	10,378
Financial assets	21,358	21,358	21,358	21,358	21,358	21,358
Cost	7,023	7,023	7,023	7,023	7,023	7,023
Acc. Depreciation	(79)	(79)	(79)	(79)	(79)	(79)
Long-term securities	6,944	6,944	6,944	6,944	6,944	6,944
Fixed assets	89,887	103,084	106,722	110,908	113,280	114,792
Other long term assets	6,457	6,457	6,457	6,457	6,457	6,457
Inventories	3,990	3,990	3,990	3,990	3,990	3,990
Financial receivables	1,417	1,417	1,417	1,417	1,417	1,417
Operating receivables	18,684	18,684	18,684	18,684	18,684	18,684
Businesses held for sale	610	610	610	610	610	610
Securities	4,448	4,448	4,448	4,448	4,448	4,448
Cash	1,739	2,863	2,918	2,758	4,644	7,045
Liquid funds	6,187	7,311	7,366	7,206	9,092	11,493
Current assets	30,888	32,012	32,067	31,907	33,793	36,194
	-	-	-	-	-	-
Total assets	**127,232**	**141,553**	**145,247**	**149,271**	**153,530**	**157,443**
	-	-	-	-	-	-
Financial liabilities - external	11,392	28,392	28,392	28,392	28,392	28,392
Financial liabilities - intra group	2,007	2,007	2,007	2,007	2,007	2,007
Operating liabilities	20,450	20,450	20,450	20,450	20,450	20,450
Other	8,528	8,057	8,057	8,057	8,057	8,057
Liabilities	42,377	58,906	58,906	58,906	58,906	58,906
Pension provisions	3,885	3,885	3,885	3,885	3,885	3,885
Nuclear provisions	13,646	13,646	13,646	13,646	13,646	13,646
Other provisions	14,562	14,562	14,562	14,562	14,562	14,562
Long term liabilities	32,093	32,093	32,093	32,093	32,093	32,093
Shareholder's equity	47,845	45,339	48,711	52,360	56,224	59,776
Minority interests	4,917	5,215	5,537	5,913	6,307	6,668
Shareholder's equity	52,762	50,554	54,248	58,272	62,531	66,444
	-	-	-	-	-	-
Total liabilities and equity	**127,232**	**141,553**	**145,247**	**149,271**	**153,530**	**157,443**

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 24

CEZ: Cash Flow Statement, 2006-11e

[Y/E Dec 31 (CZK mn)	2,006.0	2007e	2008e	2009e	2010e	2011e
Profit after tax	28,756	34,774	42,500	53,955	54,862	55,424
Depreciation & amortization	24,280	22,214	19,751	20,741	21,989	23,161
Amortisation of nuclear fuel	3,156	3,156	3,156	3,156	3,156	3,156
Operating cash flow	**62,908**	**60,144**	**65,407**	**77,852**	**80,008**	**81,741**
Capex	(23,745)	(29,396)	(33,502)	(38,235)	(40,183)	(41,765)
-maintenance		(24,096)	(22,402)	(20,035)	(20,083)	(20,865)
-growth		(5,300)	(11,100)	(18,200)	(20,100)	(20,900)
Acquisitions	(21,925)					
Disposals	3,278					
Changes in securities (restricted funds)	(902)					0
Investing cash flow	**(43,294)**	**(29,396)**	**(33,502)**	**(38,235)**	**(40,183)**	**(41,765)**
Free cash flow	19,614	30,748	31,905	39,616	39,824	39,976
- CEZ shareholders	(8,838)	(14,850)	(18,711)	(23,760)	(23,760)	(23,760)
- Minorities	(44)	(44)	(44)	(44)	(44)	(44)
Dividends	(8,882)	(14,894)	(18,755)	(23,804)	(23,804)	(23,804)
Share issues/buybacks	(1,139)	(31,809)	(31,809)	0	0	0
Issue/repayment of debt	5,354	30,000	2,000			
Financing cash flow	(4,667)	(16,704)	(48,565)	(23,804)	(23,804)	(23,804)
Net change in cash	14,947	14,045	(16,660)	15,812	16,020	16,172
FX/other changes	(806)	0	0	0		
Change in liquid funds	14,141	14,045	(16,660)	15,812	16,020	16,172
Net debt (cash)	8,558	24,513	43,173	27,361	11,341	(4,830)
Operating cash flow per share (CZK)	**109**	**107**	**122**	**146**	**150**	**153**

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 25

CEZ: Profit and Loss Account, 2006-11e

Y/E Dec 31 (CZK mn)	2006	2007e	2008e	2009e	2010e	2011e
Central Europe	181,415	142,282	160,607	181,681	185,370	188,718
South Eastern Europe	25,584	26,727	27,783	28,936	30,217	31,533
Consolidation	(47,419)	(280)	(280)	(280)	(280)	(280)
Total sales	**159,580**	**168,730**	**188,110**	**210,336**	**215,306**	**219,970**
Central Europe	57,473	66,502	77,456	92,752	94,405	95,433
South Eastern Europe	4,375	4,918	5,182	5,758	6,279	6,773
Consolidation/Others	2,496	0	0	0	0	0
Total EBITDA	**64,344**	**71,420**	**82,637**	**98,510**	**100,684**	**102,205**
Central Europe	(19,558)	(20,063)	(17,458)	(18,279)	(19,527)	(20,867)
South Eastern Europe	(2,134)	(2,151)	(2,293)	(2,462)	(2,462)	(2,293)
Consolidation/Others	(2,588)	0	0	0	0	0
Operating depreciation	(24,280)	(22,214)	(19,751)	(20,741)	(21,989)	(23,161)
Central Europe	37,915	46,440	57,114	71,453	71,876	71,578
South Eastern Europe	2,241	2,767	2,888	3,296	3,817	4,479
Consolidation	(92)	0	0	0	0	0
Total operating result	**40,064**	**49,207**	**60,002**	**74,750**	**75,693**	**76,057**
Income from associates	74	74	74	74	74	74
Non-operating results	775	0	0	0	0	0
• Interest expense	(2,236)	(2,736)	(3,186)	(2,861)	(2,611)	(2,236)
• Interest income	922	922	922	922	922	922
• Interest on provisions	(1,891)	(1,891)	(1,891)	(1,891)	(1,891)	(1,891)
• Other						
Financial earnings	(3,205)	(3,705)	(4,155)	(3,830)	(3,580)	(3,205)
Profit before tax	37,708	45,576	55,921	70,994	72,187	72,926
Current tax	(8,952)	(10,801)	(13,421)	(17,038)	(17,325)	(17,502)
Deferred tax						
Taxation	(8,952)	(10,801)	(13,421)	(17,038)	(17,325)	(17,502)
Profit after tax	28,756	34,774	42,500	53,955	54,862	55,424
Minorities	(1,059)	(1,217)	(1,487)	(1,888)	(1,920)	(1,940)
Net income (reported)	**27,697**	**33,557**	**41,012**	**52,067**	**52,942**	**53,484**
Per Share data (CZK)						
Number of shares (basic, year-end) (mn)	589.3	564.3	534.6	534.6	534.6	534.6
Number of shares (basic, average) (mn)	589.9	576.0	547.8	533.0	533.0	533.0
Number of shares (fully diluted, average) (mn)	594.0	594.0	534.6	594.0	594.0	594.0
Share options outstanding (mn)		1.8	1.8	1.8	1.8	1.8
EPS (ModelWare calculated, CZK)	**47.0**	**58.26**	**74.87**	**97.69**	**99.33**	**100.04**
	0.0	-	-	-	-	-
Dividend per share (CZK)	**15.0**	**25.00**	**35.00**	**40.00**	**40.00**	**40.00**
Dividend pay-out (%)	30	43	47	41	40	40

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 26

CEZ: Balance Sheet, 2006-11e

As of Dec 31 (CZK mn)	2006	2007e	2008e	2009e	2010e	2011e
Tangible fixed assets	269,763	273,789	284,384	298,723	313,761	329,209
Intangible fixed assets	17,820	17,820	17,820	17,820	17,820	17,820
Investments	13,707	13,707	13,707	13,707	13,707	13,707
Fixed assets	301,290	305,316	315,911	330,250	345,288	360,736
Other assets	699	699	699	699	699	699
Inventories and other current assets	10,296	10,296	10,296	10,296	10,296	10,296
Accounts receivables	16,486	16,486	16,486	16,486	16,486	16,486
Short term securities	33,263	33,263	33,263	33,263	33,263	33,263
Liquid funds	6,621	20,666	4,006	19,818	35,838	52,009
Current assets	66,666	80,711	64,051	79,863	95,883	112,054
Total assets	368,655	386,726	380,661	410,812	441,870	473,489
Total liabilities	63,985	93,985	95,985	95,985	95,985	95,985
Nuclear provisions	36,683	36,683	36,683	36,683	36,683	36,683
Mining provisions	7,175	7,175	7,175	7,175	7,175	7,175
Other liabilities	53,159	53,159	53,159	53,159	53,159	53,159
Shareholder's equity	194,937	181,835	172,326	200,633	229,815	259,538
Minority interests	12,716	13,889	15,333	17,177	19,053	20,949
Total equity	207,653	195,724	187,659	217,810	248,868	280,487
Total liabilities and equity	368,655	386,726	380,661	410,812	441,870	473,489

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 27

RWE: Cash Flow Statement, 2006-11e

Y/E Dec 31 (€ million)	2006	2007e	2008e	2009e	2010e	2011e
Profit after tax	4,015	3,182	4,048	4,092	5,076	5,260
Depreciation & amortization	3,025	2,235	2,256	2,373	2,480	2,568
Loss/gain on disposals & other	(1,368)	(262)	-	-	-	-
Changes in provisions	1,300	-	-	-	-	-
Changes in deferred tax	293	74	74	74	74	74
Changes in working capital	(534)	-	-	-	-	-
Other	54	-	-	-	-	-
Operating cash flow	**6,785**	**5,229**	**6,377**	**6,538**	**7,630**	**7,902**
Capex	(4,494)	(2,818)	(3,600)	(3,624)	(3,549)	(3,144)
Acquisitions	(234)	-	-	-	-	-
Disposals	7,854	5,616	-	-	-	-
Changes in securities	(5,597)	-	-	-	-	-
Investing cash flow	**(2,471)**	**2,798**	**(3,600)**	**(3,624)**	**(3,549)**	**(3,144)**
Free cash flow	4,314	8,027	2,778	2,914	4,081	4,758
- RWE shareholders	(984)	(1,968)	(2,418)	(2,137)	(2,165)	(2,559)
- Minorities	(224)	(235)	(247)	(259)	(272)	(286)
Dividends	(1,208)	(2,203)	(2,665)	(2,396)	(2,437)	(2,845)
Share issues/buybacks	(9)	-	-	-	-	-
Issue/repayment of debt	(1,731)	-	-	-	-	-
Financing cash flow	**(2,948)**	**(2,203)**	**(2,665)**	**(2,396)**	**(2,437)**	**(2,845)**
Net change in cash	1,366	5,824	113	518	1,643	1,913
FX/other changes	(1)	-	-	-	-	-
Change in liquid funds	1,365	5,824	113	518	1,643	1,913
Operating cash flow per share (CZK)	**13**	**9**	**11**	**12**	**14**	**14**
Net debt (cash)	(4,720)	(10,544)	(10,657)	(11,175)	(12,818)	(14,732)

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 28

RWE: Profit and Loss Account, 2006-11e

Y/E Dec 31 (€ million)	2006	2007e	2008e	2009e	2010e	2011e
Revenues	**44,256**	**44,604**	**46,308**	**47,102**	**49,158**	**49,840**
RWE Power	6,574	8,664	10,151	10,534	11,569	11,884
RWE Energy	27,398	26,940	27,328	28,009	28,909	29,109
RWE npower	8,485	8,887	8,716	8,445	8,567	8,733
RWE non-core	1,702	-	-	-	-	-
Other / Consolidation	97	114	114	114	114	114
EBITDA	**7,861**	**8,173**	**8,953**	**9,144**	**10,646**	**10,969**
RWE Power	3,372	4,440	5,019	5,138	6,323	6,453
RWE Energy	3,177	2,926	3,137	3,204	3,340	3,348
RWE npower	658	890	880	884	1,065	1,251
RWE non-core	689	-	-	-	-	-
Other / Consolidation	(35)	(82)	(82)	(82)	(82)	(82)
Equity income	388	368	358	356	356	355
RWE Power	117	120	122	124	127	130
RWE Energy	261	248	236	232	229	225
RWE npower	4	-	-	-	-	-
RWE non-core	-	-	-	-	-	-
Other / Consolidation	6	-	-	-	-	-
Operating result	**6,108**	**6,662**	**7,385**	**7,457**	**8,852**	**9,086**
RWE Power	2,746	3,814	4,347	4,374	5,476	5,544
RWE Energy	2,506	2,242	2,440	2,495	2,618	2,612
RWE npower	512	740	732	723	892	1,064
RWE non-core	425	-	-	-	-	-
Other / Consolidation	(81)	(134)	(134)	(134)	(134)	(134)
Non-operating result	(414)	(94)	(330)	(330)	(330)	(330)
Gains on disposals	463	262	-	-	-	-
Release of nuclear provisions	164	-	-	-	-	-
Goodwill amortization	(6)	-	-	-	-	-
Other non-operating result	(1,035)	(356)	(330)	(330)	(330)	(330)
Financial earnings	(2,035)	(1,342)	(1,426)	(1,435)	(1,423)	(1,393)
Net financial interest	(722)	(614)	(476)	(485)	(473)	(443)
Interest accretion to provisions	(1,143)	(950)	(950)	(950)	(950)	(950)
Other financial result	(170)	222	-	-	-	-
Income before tax	3,659	5,226	5,629	5,692	7,099	7,363
Tax	(982)	(2,195)	(1,581)	(1,601)	(2,023)	(2,102)
Income after Tax	2,677	3,031	4,048	4,092	5,076	5,260
Minority interest	(166)	(148)	(162)	(165)	(173)	(173)
Income from discontinued operations	1,338	151	-	-	-	-
Net income (reported)	**3,849**	**3,033**	**3,886**	**3,926**	**4,902**	**5,087**
% change	73	(21)	28	1	25	4
EPS (reported) (€)	6.84	5.39	6.91	6.98	8.72	9.05
EPS (ModelWare) (€)	**4.39**	**5.76**	**7.32**	**7.39**	**9.13**	**9.46**
DPS (€)	**3.50**	**4.30**	**3.80**	**3.85**	**4.55**	**4.70**
Payout ratio (recurrent) (%)	80	75	52	52	50	50

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

Exhibit 29

RWE: Balance Sheet, 2006-11e

As of Dec 31 (€ million)	2006	2007e*	2008e	2009e	2010e	2011e
Tangible fixed assets	26,034	24,296	25,969	27,551	28,950	29,856
Intangible fixed assets	14,901	11,868	11,538	11,208	10,878	10,548
Investments	3,917	3,917	3,917	3,917	3,917	3,917
Other financial assets	4,520	4,520	4,520	4,520	4,520	4,520
Fixed assets	49,372	44,601	45,944	47,196	48,265	48,841
Other assets	4,633	4,559	4,485	4,411	4,337	4,263
Inventories	2,226	2,226	2,226	2,226	2,226	2,226
Accounts receivables	17,642	17,642	17,642	17,642	17,642	17,642
Short term securities	16,788	9,001	9,001	9,001	9,001	9,001
Liquid funds	2,794	16,405	16,518	17,036	18,679	20,593
Current assets	39,450	45,274	45,387	45,905	47,548	49,462
Total assets	**93,455**	**94,433**	**95,816**	**97,511**	**100,150**	**102,566**
Financial liabilities - external	19,382	19,382	19,382	19,382	19,382	19,382
Financial liabilities - intercompany	-	-	-	-	-	-
Other liabilities	13,292	13,292	13,292	13,292	13,292	13,292
Total liabilities	32,674	32,674	32,674	32,674	32,674	32,674
Pension provisions	11,584	11,584	11,584	11,584	11,584	11,584
Nuclear provisions	8,834	8,834	8,834	8,834	8,834	8,834
Mining provisions	2,548	2,548	2,548	2,548	2,548	2,548
Other provisions	11,100	11,100	11,100	11,100	11,100	11,100
Total provisions	34,066	34,066	34,066	34,066	34,066	34,066
Other liabilities	12,602	12,602	12,602	12,602	12,602	12,602
Op bal	11,431	13,442	14,506	15,974	17,763	20,500
Net income	3,849	3,033	3,886	3,926	4,902	5,087
Dividends	(984)	(1,968)	(2,418)	(2,137)	(2,165)	(2,559)
Issues (buybacks)	(855)	-	-	-	-	-
Shareholder's equity	13,442	14,506	15,974	17,763	20,500	23,029
Op bal	926	672	586	500	407	308
Net income	166	148	162	165	173	173
Dividends	(224)	(235)	(247)	(259)	(272)	(286)
Other	(196)	-	-	-	-	-
Minority interests	672	586	500	407	308	195
Total equity	14,114	15,092	16,474	18,170	20,808	23,224
Total liabilities and equity	**93,455**	**94,433**	**95,816**	**97,511**	**100,150**	**102,566**

*The balance sheet, in contrast to our SOP valuation does not reflect the transfer of €7 8 billion pension provisions and financial assets into a CTA as of this year.

e = Morgan Stanley Research estimates

Source: Company data, Morgan Stanley Research

MORGAN STANLEY ModelWare	**Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations.** For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.

Disclosure Section

Morgan Stanley & Co. International plc, authorised and regulated by Financial Services Authority, disseminates in the UK research that it has prepared, and approves solely for the purposes of section 21 of the Financial Services and Markets Act 2000, research which has been prepared by any of its affiliates.

Analyst Certification

The following analysts hereby certify that their views about the companies and their securities discussed in this report are accurately expressed and that they have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report: Tanja Markloff.

Unless otherwise stated, the individuals listed on the cover page of this report are research analysts.

Global Research Conflict Management Policy

Morgan Stanley Research has been published in accordance with our conflict management policy, which is available at www.morganstanley.com/institutional/research/conflictpolicies.

Important US Regulatory Disclosures on Subject Companies

As of September 28, 2007, Morgan Stanley beneficially owned 1% or more of a class of common equity securities of the following companies covered in Morgan Stanley Research: ACEA, Biffa, British Energy, Drax, E.ON, EDP, ENDESA, ENEL, Fortum, Iberdrola, Kelda Group, National Grid plc, Northumbrian Water Group, Pennon Group, Red Electrica, RWE AG, Scottish & Southern, Severn Trent, Snam Rete Gas, Terna, Veolia Environnement.

As of October 4, 2007, Morgan Stanley held a net long or short position of US$1 million or more of the debt securities of the following issuers covered in Morgan Stanley Research (including where guarantor of the securities): British Energy, Centrica, E.ON, EDF, Edison, EDP, ENDESA, ENEL, Fortum, Gas Natural, Gaz De France, Iberdrola, International Power, Kelda Group, National Grid plc, RWE AG, Scottish & Southern, Severn Trent, Snam Rete Gas, Suez, Union Fenosa, United Utilities, Veolia Environnement.

Within the last 12 months, Morgan Stanley managed or co-managed a public offering of securities of Union Fenosa, Veolia Environnement.

Within the last 12 months, Morgan Stanley has received compensation for investment banking services from E.ON, EDF, EDP, ENDESA, ENEL, Fortum, Gas Natural, Iberdrola, International Power, RWE AG, Scottish & Southern, Suez, Union Fenosa, Veolia Environnement.

In the next 3 months, Morgan Stanley expects to receive or intends to seek compensation for investment banking services from ACEA, AEM Milano, ASM Brescia, British Energy, Centrica, E.ON, EDF, Edison, EDP, Enagas, ENDESA, ENEL, Fortum, Gas Natural, Gaz De France, Iberdrola, International Power, IRIDE S.p.A., Kelda Group, Northumbrian Water Group, Pennon Group, PPC, Red Electrica, RWE AG, Scottish & Southern, Severn Trent, Snam Rete Gas, Suez, Terna, Union Fenosa, Veolia Environnement.

Within the last 12 months, Morgan Stanley & Co. Incorporated has received compensation for products and services other than investment banking services from AEM Milano, ASM Brescia, British Energy, E.ON, EDF, EDP, ENDESA, ENEL, Fortum, Gas Natural, Gaz De France, Iberdrola, International Power, National Grid plc, RWE AG, Scottish & Southern, Suez.

Within the last 12 months, Morgan Stanley has provided or is providing investment banking services to, or has an investment banking client relationship with, the following company: ACEA, AEM Milano, ASM Brescia, British Energy, Centrica, E.ON, EDF, Edison, EDP, Enagas, ENDESA, ENEL, Fortum, Gas Natural, Gaz De France, Iberdrola, International Power, IRIDE S.p.A., Kelda Group, Northumbrian Water Group, Pennon Group, PPC, Red Electrica, RWE AG, Scottish & Southern, Severn Trent, Snam Rete Gas, Suez, Terna, Union Fenosa, Veolia Environnement.

Within the last 12 months, Morgan Stanley has either provided or is providing non-investment banking, securities-related services to and/or in the past has entered into an agreement to provide services or has a client relationship with the following company: AEM Milano, ASM Brescia, British Energy, Centrica, CEZ, E.ON, EDF, Edison, EDP, Enagas, ENDESA, ENEL, Fortum, Gas Natural, Gaz De France, Iberdrola, International Power, National Grid plc, PPC, RWE AG, Scottish & Southern, Suez, Union Fenosa, United Utilities, Veolia Environnement.

The research analysts, strategists, or research associates principally responsible for the preparation of Morgan Stanley Research have received compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors, firm revenues and overall investment banking revenues.

Morgan Stanley & Co. International plc is a corporate broker to International Power, National Grid plc, Severn Trent.

Certain disclosures listed above are also for compliance with applicable regulations in non-US jurisdictions.

STOCK RATINGS

Different securities firms use a variety of rating terms as well as different rating systems to describe their recommendations. For example, Morgan Stanley uses a relative rating system including terms such as Overweight, Equal-weight or Underweight (see definitions below). A rating system using terms such as buy, hold and sell is not equivalent to our rating system. Investors should carefully read the definitions of all ratings used in Morgan Stanley Research. In addition, since Morgan Stanley Research contains more complete information concerning the analyst's views, investors should carefully read Morgan Stanley Research, in its entirety, and not infer the contents from the rating alone. In any case, ratings (or research) should not be used or relied upon as investment advice. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations.

Global Stock Ratings Distribution

(as of September 30, 2007)

For disclosure purposes only (in accordance with NASD and NYSE requirements), we include the category headings of Buy, Hold, and Sell alongside our ratings of Overweight, Equal-weight and Underweight. Morgan Stanley does not assign ratings of Buy, Hold or Sell to the stocks we cover. Overweight, Equal-weight, and Underweight are not the equivalent of buy, hold, and sell but represent recommended relative weightings (see definitions below). To satisfy regulatory requirements, we correspond Overweight, our most positive stock rating, with a buy recommendation; we correspond Equal-weight and Underweight to hold and sell recommendations, respectively.

	Coverage Universe		Investment Banking Clients (IBC)		
Stock Rating Category	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	**966**	**42%**	**330**	**44%**	**34%**
Equal-weight/Hold	**1017**	**44%**	**326**	**44%**	**32%**
Underweight/Sell	**317**	**14%**	**88**	**12%**	**28%**
Total	**2,300**		**744**		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.

Analyst Stock Ratings

Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Equal-weight (E). The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Underweight (U). The stock's total return is expected to be below the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

More volatile (V). We estimate that this stock has more than a 25% chance of a price move (up or down) of more than 25% in a month, based on a quantitative assessment of historical data, or in the analyst's view, it is likely to become materially more volatile over the next 1-12 months compared with the past three years. Stocks with less than one year of trading history are automatically rated as more volatile (unless otherwise noted). We note that securities that we do not currently consider "more volatile" can still perform in that manner.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

Stock price charts and rating histories for companies discussed in Morgan Stanley Research are available at www.morganstanley.com/companycharts or from your local investment representative. You may also request this information by writing to Morgan Stanley at 1585 Broadway, (Attention: Equity Research Management), New York, NY, 10036 USA.

Other Important Disclosures

For a discussion, if applicable, of the valuation methods used to determine the price targets included in Morgan Stanley Research, and the risks related to achieving these targets, please refer to the latest relevant published research on these stocks. Research is available through your sales representative or on Client Link at www.morganstanley.com and other electronic systems.

Morgan Stanley Research does not provide individually tailored investment advice. Morgan Stanley Research has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. The securities/instruments discussed in Morgan Stanley Research may not be suitable for all investors. Morgan Stanley recommends that investors independently evaluate particular investments and strategies, and encourages investors to seek the advice of a financial adviser. The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives. The securities, instruments, or strategies discussed in Morgan Stanley Research may not be suitable for all investors, and certain investors may not be eligible to purchase or participate in some or all of them.

Morgan Stanley Research is not an offer to buy or sell or the solicitation of an offer to buy or sell any security/instrument or to participate in any particular trading strategy. The "Important US Regulatory Disclosures on Subject Companies" section in Morgan Stanley Research lists all companies mentioned where Morgan Stanley owns 1% or more of a class of common securities of the companies. For all other companies mentioned in Morgan Stanley Research, Morgan Stanley may have an investment of less than 1% in securities or derivatives of securities of companies and may trade them in ways different from those discussed in Morgan Stanley Research. Employees of Morgan Stanley not involved in the preparation of Morgan Stanley Research may have investments in securities or derivatives of securities of companies mentioned and may trade them in ways different from those discussed in Morgan Stanley Research. Derivatives may be issued by Morgan Stanley or associated persons

Morgan Stanley and its affiliate companies do business that relates to companies/instruments covered in Morgan Stanley Research, including market making and specialized trading, risk arbitrage and other proprietary trading, fund management, commercial banking, extension of credit, investment services and investment banking. Morgan Stanley sells to and buys from customers the securities/instruments of companies covered in Morgan Stanley Research on a principal basis.

With the exception of information regarding Morgan Stanley, research prepared by Morgan Stanley Research personnel are based on public information. Morgan Stanley makes every effort to use reliable, comprehensive information, but we make no representation that it is accurate or complete. We have no obligation to tell you when opinions or information in Morgan Stanley Research change apart from when we intend to discontinue research coverage of a subject company. Facts and views presented in Morgan Stanley Research have not been reviewed by, and may not reflect information known to, professionals in other Morgan Stanley business areas, including investment banking personnel.

Morgan Stanley Research personnel conduct site visits from time to time but are prohibited from accepting payment or reimbursement by the company of travel expenses for such visits.

The value of and income from your investments may vary because of changes in interest rates or foreign exchange rates, securities prices or market indexes, operational or financial conditions of companies or other factors. There may be time limitations on the exercise of options or other rights in your securities transactions. Past performance is not necessarily a guide to future performance. Estimates of future performance are based on assumptions that may not be realized. Unless otherwise stated, the cover page provides the closing price on the primary exchange for the subject company's securities/instruments.

To our readers in Taiwan: Information on securities/instruments that trade in Taiwan is distributed by Morgan Stanley Taiwan Limited ("MSTL"). Such information is for your reference only. The reader should independently evaluate the investment risks and is solely responsible for their investment decisions. Morgan Stanley Research may not be distributed to the public media or quoted or used by the public media without the express written consent of Morgan Stanley. Information on securities/instruments that do not trade in Taiwan is for informational purposes only and is not to be construed as a recommendation or a solicitation to trade in such securities/instruments. MSTL may not execute transactions for clients in these securities/instruments.

To our readers in Hong Kong: Information is distributed in Hong Kong by and on behalf of, and is attributable to, Morgan Stanley Asia Limited as part of its regulated activities in Hong Kong. If you have any queries concerning Morgan Stanley Research, please contact our Hong Kong sales representatives.

Morgan Stanley Research is disseminated in Japan by Morgan Stanley Japan Securities Co., Ltd.; in Hong Kong by Morgan Stanley Asia Limited (which accepts responsibility for its contents); in Singapore by Morgan Stanley Asia (Singapore) Pte. (Registration number 199206298Z) and/or Morgan Stanley Asia (Singapore) Securities Pte Ltd (Registration number 200008434H), regulated by the Monetary Authority of Singapore, which accepts responsibility for its contents; in Australia by Morgan Stanley Australia Limited A.B.N. 67 003 734 576, holder of Australian financial services licence No. 233742, which accepts responsibility for its contents; in Korea by Morgan Stanley & Co International plc, Seoul Branch; in India by Morgan Stanley India Company Private Limited; in Canada by Morgan Stanley Canada Limited, which has approved of, and has agreed to take responsibility for, the contents of Morgan Stanley Research in Canada; in Germany by Morgan Stanley Bank AG, Frankfurt am Main, regulated by Bundesanstalt fuer Finanzdienstleistungsaufsicht (BaFin); in Spain by Morgan Stanley, S.V., S.A., a Morgan Stanley group company, which is supervised by the Spanish Securities Markets Commission (CNMV) and states that Morgan Stanley Research has been written and distributed in accordance with the rules of conduct applicable to financial research as established under Spanish regulations; in the United States by Morgan Stanley & Co. Incorporated, which accepts responsibility for its contents. Morgan Stanley & Co. International plc, authorized and regulated by Financial Services Authority, disseminates in the UK research that it has prepared, and approves solely for the purposes of section 21 of the Financial Services and Markets Act 2000, research which has been prepared by any of its affiliates. Private U.K. investors should obtain the advice of their Morgan Stanley & Co. International plc representative about the investments concerned. In Australia, Morgan Stanley Research and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act.

The information in Morgan Stanley Research is being communicated by Morgan Stanley & Co. International plc (DIFC Branch), regulated by the Dubai Financial Services Authority (the DFSA), and is directed at wholesale customers only, as defined by the DFSA. This research will only be made available to a wholesale customer who we are satisfied meets the regulatory criteria to be a client.

The information in Morgan Stanley Research is being communicated by Morgan Stanley & Co. International plc (QFC Branch), regulated by the Qatar Financial Centre Regulatory Authority (the QFCRA), and is directed at business customers and market counterparties only and is not intended for Retail Customers as defined by the QFCRA.

The trademarks and service marks contained in Morgan Stanley Research are the property of their respective owners. Third-party data providers make no warranties or representations of any kind relating to the accuracy, completeness, or timeliness of the data they provide and shall not have liability for any damages of any kind relating to such data. The Global Industry Classification Standard ("GICS") was developed by and is the exclusive property of MSCI and S&P.

Additional information on recommended securities/instruments is available on request.

Morgan Stanley

MORGAN STANLEY RESEARCH

The Americas
1585 Broadway
New York, NY 10036-8293
United States
Tel: +1 (1) 212 761 4000

Europe
25 Cabot Square, Canary Wharf
London E14 4QA
United Kingdom
Tel: +44 (0) 20 7 425 8000

Japan
4-20-3 Ebisu, Shibuya-ku
Tokyo 150-6008
Japan
Tel: +81 (0) 3 5424 5000

Asia/Pacific
Three Exchange Square
Central
Hong Kong
Tel: +852 2848 5200

Industry Coverage:Utilities

Company (Ticker)	Rating (as of)	Price (10/12/2007)
Antonella Bianchessi		
ACEA (ACE.MI)	U (01/24/2007)	€13.84
AEM Milano (AEMI.MI)	O (07/12/2006)	€2.81
ASM Brescia (AMBR.MI)	O (06/05/2007)	€4.58
EDP (EDP.LS)	O (06/21/2006)	€4.25
ENDESA (ELE.MC)	NA (10/09/2007)	€37.57
ENEL (ENEI.MI)	NA (10/09/2007)	€8.2
Edison (EDN.MI)	O (11/22/2006)	€2.4
Enagas (ENAG.MC)	O (09/22/2006)	€19.2
Gas Natural (GAS.MC)	O (04/16/2007)	€38.97
IRIDE S.p.A. (IRD.MI)	E (06/22/2007)	€2.63
Iberdrola (IBE.MC)	E (08/01/2007)	€10.77
PPC (DEHr.AT)	U (12/15/2004)	€29
Snam Rete Gas (SRG.MI)	E (03/16/2006)	€4.53
Terna (TRN.MI)	O (05/23/2007)	€2.62
Bobby Chada		
Biffa (BIFF.L)	E-V (02/13/2007)	255p
British Energy (BGY.L)	E-V (09/11/2007)	572p
CEZ (CEZP.PR)	E (07/26/2007)	CZK1,275
Centrica (CNA.L)	O (06/26/2007)	383p
Drax (DRX.L)	E (01/18/2006)	609p
International Power (IPR.L)	O (11/03/2005)	467p
Kelda Group (KEL.L)	U (09/05/2006)	934p
National Grid plc (NG.L)	O (11/16/2006)	781p
Northumbrian Water Group (NWG.L)	O (04/10/2007)	338p
Pennon Group (PNN.L)	E (09/05/2006)	647p
Scottish & Southern (SSE.L)	E (01/11/2007)	1,528p
Severn Trent (SVT.L)	E (04/10/2007)	1,455p
United Utilities (UU.L)	U (11/26/2004)	738p
Red Electrica (REE.MC)	U (11/03/2004)	€39.85
Union Fenosa (UNF.MC)	U (11/24/2005)	€43.03
Tanja Markloff		
E.ON (EONG.DE)	NA (04/10/2007)	€127.9
RWE AG (RWEG.DE)	O (11/27/2006)	€89.44
Emmanuel Turpin		
EDF (EDF.PA)	O (01/13/2006)	€77.52
Fortum (FUM1V.HE)	E-V (04/27/2007)	€26.71
Gaz De France (GAZ.PA)	++	€37.84
Suez (LYOE.PA)	++	€42.55
Veolia Environnement (VIE.PA)	O (06/19/2006)	€62.6

Stock Ratings are subject to change Please see latest research for each company

E.ON AG (EONG.DE)

Reinstating Coverage: €130 Price Target

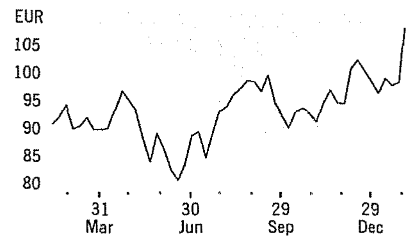
Rating change
Target price change ☑
Estimate change ☑

- **Buy/ Medium Risk** — We are resuming coverage of E.On with a price target of €130. Under our base case, we estimate the acquisition of Endesa by E.On will enhance FY08E EPS by 19%, leaving E.On trading on an underlying FY08E P/E of just 9.4x, even after the recent rise in the share price.
- **Net €9 Per Share Positive Impact** — E.On's final offer represents a 14% premium to our standalone valuation of Endesa, equivalent to €5.6 per E.On share of potential value destruction. However, this is more than offset by €4.3 per E.On share worth of claimed operational synergies and some €10.3 per E.On share attributable to the value of leveraging up the E.On balance sheet.
- **Compelling Valuation** — Our E.On SoP now stands at €130 per share assuming it acquires a 75% stake in Endesa. On this basis, the current E.On share price implies an FY08E EV/EBITDA of 7.3x and an FY08E dividend yield of 5.4%.
- **Several Hurdles to Overcome** — It is still possible that the deal will fail completely, or that E.On will end up with a minority stake. In both cases we would expect short-term share price weakness, but we would still see scope for medium-term upside. Our SoP would be little affected. Even if E.On were left with a stake of just 45%, the deal would enhance FY08E EPS by 10%.
- **E.On May Issue Equity** — E.On says that if it ends up with more than 60-70% of Endesa it would need to sell assets or issue equity to achieve its credit rating goal. The company says it favours asset sales over equity issuance. At our base case we think some €5bn of sales would be needed. We identify some €30bn worth of assets we think E.On could consider selling.

See Appendix A-1 for Analyst Certification and important disclosures.

Buy/Medium Risk	**1M**
Price (02 Feb 07)	€109.43
Target price	€130.00
from €100.00	
Expected share price return	18.8%
Expected dividend yield	3.7%
Expected total return	**22.5%**
Market Cap	€75,726M
	US$98,205M

Price Performance (RIC: EONG.DE, BB: EOA GR)



E.ON AG (EUR)

Year to 31 Dec	2004A	2005A	2006E	2007E	2008E
Sales (€M)	42,384.0	51,854.0	67,277.8	67,822.8	66,697.8
Net Income (€M)	3,256.0	3,620.9	4,310.9	5,168.8	5,451.1
Diluted EPS (€)	4.96	5.49	6.54	7.84	8.27
Diluted EPS (Old) (€)	5.52	5.87	6.60	6.84	6.84
PE (x)	22.1	19.9	16.7	14.0	13.2
EV/EBITDA (x)	9.9	9.2	7.7	7.4	7.0
DPS (€)	2.35	7.00	4.00	4.70	4.84
Net Div Yield (%)	2.1	6.4	3.7	4.3	4.4

Daniel Martin[1]
+44-20-7986-4119
daniel.martin@citigroup.com

Alejandro Vigil[1]
+34-91-538-4384
alejandro.vigilgarcia@citigroup.com

[1]Citigroup Global Markets Ltd

Fiscal year end 31-Dec	2004	2005	2006E	2007E	2008E
Valuation Ratios					
P/E adjusted (x)	22.1	19.9	16.7	14.0	13.2
EV/EBITDA adjusted (x)	9.9	9.2	7.7	7.4	7.0
P/BV (x)	2.1	1.6	1.7	1.6	1.6
Dividend yield (%)	2.1	6.4	3.7	4.3	4.4
Per Share Data (€)					
EPS adjusted	4.96	5.49	6.54	7.84	8.27
EPS reported	6.61	11.24	5.51	7.84	8.27
BVPS	50.91	67.49	64.76	67.15	70.58
DPS	2.35	7.00	4.00	4.70	4.84
Profit & Loss (€M)					
Net sales	42,384	51,854	67,278	67,823	66,698
Operating expenses	-36,212	-45,762	-60,306	-59,645	-57,732
EBIT	**6,172**	**6,092**	**6,972**	**8,177**	**8,965**
Net interest expense	-1,062	-736	-749	-847	-1,003
Non-operating/exceptionals	1,245	1,852	-955	779	794
Pre-tax profit	**6,355**	**7,208**	**5,268**	**8,110**	**8,756**
Tax	-1,850	-2,276	-1,338	-2,468	-2,809
Extraord./Min.Int./Pref.div.	-166	2,475	-300	-473	-496
Reported net income	**4,339**	**7,407**	**3,630**	**5,169**	**5,451**
Adjusted earnings	3,256	3,621	4,311	5,169	5,451
Adjusted EBITDA	9,346	9,312	10,642	11,520	12,532
Growth Rates (%)					
Sales	9.6	22.3	29.7	0.8	-1.7
EBIT adjusted	14.5	5.9	15.5	12.4	9.5
EBITDA adjusted	10.9	-0.4	14.3	8.2	8.8
EPS adjusted	17.0	10.7	19.1	19.9	5.5
Cash Flow (€M)					
Operating cash flow	**6,142**	**6,523**	**5,565**	**7,923**	**8,460**
Depreciation/amortization	2,954	2,939	3,191	3,147	3,366
Net working capital	-763	-1,027	-596	-598	-600
Investing cash flow	**-2,888**	**1,783**	**-7,459**	**-6,359**	**-7,409**
Capital expenditure	-2,612	-2,990	-4,659	-6,359	-7,409
Acquisitions/disposals	-276	4,773	-2,800	0	0
Financing cash flow	**-1,731**	**-5,281**	**-8,225**	**-1,564**	**-1,051**
Borrowings	-74	-3,490	-3,366	1,298	2,283
Dividends paid	-1,598	-1,794	-4,859	-2,862	-3,334
Change in cash	**1,523**	**3,025**	**-10,119**	**0**	**0**
Balance Sheet (€M)					
Total assets	**114,062**	**126,562**	**114,577**	**118,384**	**123,534**
Cash & cash equivalent	12,016	15,119	5,000	5,000	5,000
Accounts receivable	6,534	8,269	8,434	8,603	8,775
Net fixed assets	43,563	41,323	44,390	47,962	52,830
Total liabilities	**76,358**	**77,344**	**66,928**	**68,928**	**71,570**
Accounts payable	3,662	5,288	5,394	5,502	5,612
Total Debt	18,333	12,416	9,050	10,348	12,631
Shareholders' funds	**37,704**	**49,218**	**47,649**	**49,456**	**51,964**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	22.1	18.0	15.8	17.0	18.8
ROE adjusted	10.3	9.3	9.9	11.9	12.0
ROIC adjusted	6.0	5.8	8.2	7.5	7.7
Net debt to equity	16.8	-5.5	8.5	10.8	14.7
Total debt to capital	32.7	20.1	16.0	17.3	19.6

For further data queries on Citigroup's full coverage universe please contact CIR Data Services Europe at CitiResearchDataServices@citigroup.com or +44-207-986-4050

Powered by: dataCentral

Reinstating Coverage: €130 Price Target

The purpose of this report is to reinstate our coverage of E.On with a Buy/ Medium Risk (1M) rating. We think the valuation case on E.On is compelling under all likely outcomes of the Endesa transaction. We think the share price should continue to rise as the uncertainties surrounding the deal are resolved and as E.On's management team begins to set out the new equity story. Our target price is €130 per share. Please also see our report *Iberian Utilities: Sector Update: Reinstating Coverage of Endesa and Gas Natural*, published today.

Background

Now that the E.On bid for Endesa appears to be entering the home stretch, we are resuming coverage post the restricted period. Here we provide a brief overview of the likely impact of the transaction on E.On and publish our latest valuations and financial models.

Figure 1. Key Dates

Date	Event
26 January 2007	Acceptance period opened
2 February 2007	E.On submitted final bid
6 February 2007	Endesa board to meet to discuss offer. Expected to call EGM on voting rights and may or may not recommend E.On offer
2H March 2007	Endesa EGM to be held. Majority of all voting capital needed to lift block on voting rights.
end March/early April	Acceptance period closes and settlement date

Source: E.On presentation 3 February 2007, *Reuters* and Citigroup Investment Research

E.On Plus Endesa: Base Case P&L

We assume E.On ends up with a 75% stake in Endesa as our base case

Figure 2 below sets out our base case for E.On after the completion of the Endesa transaction. We assume the transaction completes at the start of 2Q07 with E.On paying the announced price of €38.75 per share in cash and acquiring a 75% stake in Endesa.

Clearly, there are a number of hurdles to overcome before this scenario comes about, but we think it is a realistic possibility. It basically requires E.On to successfully acquire just over 50% of the stock during the tender process and Acciona to stick to its stated plan of tendering its 21% stake in Endesa to E.On should E.On acquire control.

Under our base case we find that:

- The deal is 10% EPS enhancing in 2007, rising to 19% in 2008; and that it
- Involves an overpayment of €3.9bn compared with our €34 per share standalone valuation of Endesa.

Figure 2. Financial Impact of E.On Acquisition by E.On of a 75% Stake in Endesa (€m Unless Stated)_

	2007E				2008E			
	E.On	Endesa	Deal impact and synergies	Total*	E.On	Endesa	Deal impact and synergies	Total
Sales	67,823	20,186		81,953	66,698	20,740		87,438
Adjusted EBITDA including associates	12,299	7,365	100	17,525	13,326	7,882	300	21,508
Depreciation	-3,147	-1,976		-4,530	-3,366	-2,104		-5,469
Adjusted EBIT	9,152	5,389		12,994	9,960	5,778		16,038
of which associates & income from investments	779	51		815	794	53		846
Adjusted interest income	-1,042	-1,048	-1,791	-3,030	-1,204	-1,115	-1,786	-4,106
Net book gains	0	0		0	0	0		0
Restructuring costs and non-operating earnings	0	0		0	0	0		0
Other non-operating earnings	0	350		245	0	150		150
Pre-tax profit	8,110	4,691	-1,691	10,210	8,756	4,813	-1,486	12,083
Tax	-2,468	-1,266	592	-2,941	-2,809	-1,300	520	-3,588
Minorities	-473	-645	-695	-1,410	-496	-672	-710	-1,879
Discontinued items/other	0	0		0	0	0		0
Net attributable profit	5,169	2,779		5,859	5,451	2,842		6,616
Adjusted net profit	5,169	2,534		5,687	5,451	2,737		6,511
EPS (€)	7.84			8.63	8.27			9.88
DPS at 60% payout (€)	4.70			5.18	4.96			5.93
Earnings enhancement				**10%**				**19%**
Operating cash flow	7,923	5,300	-1,794	11,429	8,460	5,517	-1,677	12,301
Capex	-6,359	-4,250		-10,609	-7,409	-3,755		-11,164
Free cash flow	1,564	1,050		820	1,051	1,762		1,137
Cost of dividend	3,101			3,412	3,271			3,907
Net debt	4,188	17,555	32,564	54,307	6,471	18,124	32,481	57,076
Pension provisions	3,652	3,242		6,894	-3,750	3,242		-508
Minority interest	5,195	5,622	11,017	21,835	5,443	6,093	11,838	23,374
Associates	17,339	1,850		19,189	17,735	1,877		19,612
Other liabilities	12,425			12,425	12,425			12,425
EBITDA/Net cash interest	38.3			7.6	29.1			6.4
EBITDA/Net debt	2.9			0.3	2.1			0.4
Net debt + provisions/EBITDA	1.8			4.3	1.3			3.3

*Includes 75% of Endesa's P&L as we assume the deal completes at the end of 1Q07.
Source: Citigroup Investment Research

Our view remains that the key benefits of the deal are financial in nature. Even so, they should not be underestimated.

Leverage has a high value, in our view

The deal completely transforms the E.On balance sheet, taking it from being too underleveraged up to a reasonable level of efficiency. In fact, under our base case scenario, the main balance sheet ratios may be too stretched for E.On to maintain its target of a single A, flat credit rating. As a result, we would expect to see some asset disposals or even equity issuance from E.On to slightly reduce its level of indebtedness. Our view is that we would much prefer the credit rating target to be missed than for EON to issue equity.

These possibilities and other alternative scenarios are discussed more fully below. But first, we review the valuation implications of the transaction for E.On shareholders.

Valuation implications

Convincing investors that there is more to the deal than balance sheet efficiency is the key challenge facing the E.On management team after the remaining uncertainties surrounding the deal are resolved.

The main strategic argument for the deal appears to be to assemble market power on a pan-European scale. This sounds a good idea in theory, but unfortunately we think it will only have a value when a true pan-European power market has evolved. We suspect this is 10-20 years away.

Here we concentrate, first, on the implications of the deal for fundamental value and, second, the projected valuation ratios for E.On with Endesa.

Synergies valued at €4bn

Although we are sceptical about the value of the long-term strategic benefits of the deal, it is helpful that E.On has begun to identify some nearer-term operational synergies amounting to €600m a year by 2010. These are said to have negligible costs to capture and are summarised in the following table.

We take E.On's claims at face value

Figure 3. Claimed Synergies

	Claimed amount
Best practice transfer E.On/Iberia	€235m
Procurement synergies	€220m
Best practice transfer E.On/LatAm	€90m
Combining organisations in overlapping markets	€55m
Total	€600m

Source: E.On presentation 3 February 2007

We think it is reasonable to take E.On's claims at face value and we provisionally attribute a value of €4bn to these savings. This is based on a simple DCF calculation with an 8% post-tax discount rate and a 35% tax rate, but equates to a 2010E EV/EBITDA of 6.8x, or a P/E of 10.5x.

Leverage valued at €7bn

In addition, the value of leveraging up the E.On balance sheet also needs to be taken into account. As Figure 2 suggests, the combined business pays some €1.8bn a year of additional interest compared with the two companies on a standalone basis and therefore avoids some €0.6bn a year of tax. Placing this saving on a FY07E P/E of 12x results in a value of €7.1bn.

Figure 4. Impact of Acquisition on Value

	Value (€m)	Value per E.On share (€)	Comment
Price paid for 75% stake	30,770	44	
Citigroup standalone value of 75% stake in Endesa	26,897	39	
Premium paid for 75% of Endesa	3,873	6	
75% of synergies	3,000	4	We assume 25% goes to minority shareholders
Value of leveraging up E.On balance sheet	7,102	10	Crudely based on 12x P/E
Net value impact of the deal	6,485	9	Substantial net positive impact for E.On shareholders

Source: Citigroup Investment Research

Value enhancing by €9 per E.On share

Overall, we estimate the deal has a net positive impact on the value of E.On to the tune of some €9 per E.On share. In fact, the synergies by themselves are nearly enough to close the gap between our Ensdesa SoP and the price E.On is paying.

€130 per share Sum of Parts

Figure 5 sets out our SoP for the combined business. Our standalone SoP for E.On stands at €134 per share based on a €55/MWh long-run achieved power price in Germany and a 35% shortfall of carbon permits for 2008-12. However, we believe this valuation already takes into account the value of leveraging up the E.On balance sheet as we discount rates and EV/EBITDA multiples that are really only valid for a reasonably leveraged business.

Figure 5. E.On + Endesa Sum of Parts

	E.On standalone (€m)	Endesa standalone (€m)	Synergies and cost of deal (€m)	Total value (€m)	Value per share (€m)	Method	FY08E EBITDA ex associates (€m)	Reality check
Central Europe	55,294			55,294	80	Chiefly based on DCF of component parts	6,924	8.0x FY08E EV/EBITDA
Endesa Spain		36,733	1,567	38,300	55	Chiefly based on DCF plus synergies	4,379	8.7x FY08E EV/EBITDA
Endesa Europe		7,726	367	8,093	12	Chiefly based on DCF plus synergies	1,204	6.7x FY08E EV/EBITDA
Endesa LatAm		17,239	600	17,839	26	Chiefly based on market value plus synergies	2,437	7.3x FY08E EV/EBITDA
Pan-European gas	15,134			15,134	22	DCF/RAB benchmarking	2,093	7.2x FY08E EV/EBITDA
UK	13,643			13,643	20	£0.4m/MW, £160 per cust., 10% premium to RABs	1,920	7.1x FY08E EV/EBITDA
Nordic	9,392			9,392	14	8.0x FY07E EBITDA multiple	1,317	7.1x FY08E EV/EBITDA
US-Midwest	4,207			4,207	6	7.5x FY07E EBITDA multiple	573	7.3x FY08E EV/EBITDA
Corporate centre	-2,065		1,467	-598	-1	7.5x FY07E EBITDA plus procurement savings	-185	
Total core businesses	**95,606**	**61,698**	**4,000**	**161,304**	**233**		**20,661**	**7.8x FY08E EFV/EBITDA**
Financial assets	21,735	2,653		24,389	35	Book value at 30/9/06 save for Gazprom		
inc 6.4% of Gazprom	*11,627*			*11,627*	*17*	Current market value		
Total	**117,341**	**64,351**	**4,000**	**185,692**	**268**		**20,661**	
Net cash	-4,188	-17,555	-30,770	-52,513	-76	Forecast book value at 31/12/07 plus price paid for Endesa		
Pension liabilities	-3,652	-3,242		-6,894	-10	Forecast book value at 31/12/07		
Nuclear liabilities	-8,171	0		-8,171	-12	Based on our model - current book value is €12.3bn		
Other liabilities	-4,254	0		-4,254	-6	Based on our model - current book value is €13.0bn		
Minorities	-5,195	-7,691	-11,257	-24,143	-35	Forecast book value at 31/12/07 - inc minority share of synergies and Endesa at price paid		
Net equity value	**91,882**	**35,863**	**-38,027**	**89,718**	**130**	**13.1x P/E multiple (ex Gazprom) in 2008E**		

Source: Citigroup Investment Research

As a result, our SoP for the combined business comes out a touch lower at €130 per E.On share. The implied core EV/EBITDA multiple at our target price is a relatively reassuring 7.8x for FY08E, which compares with the current sector average of 8x.

Valuation Ratios

Our €130 SoP, which we adopt as our target price, is nearly 20% above the current share price. However, we think the valuation case for E.On is most powerfully made using the conventional valuation ratios.

FY08E P/E ratio and dividend yield are particularly attractive

As Figure 6 shows, the P/E and dividend yield ratios are particularly compelling, in our view. We think it is reasonable to strip E.On's 6.4% stake in Gazprom out of the share price, as this stake has an immaterial impact on E.On's P&L and yet has a market value of over €16 per E.On share. On this basis, the merged business is still trading on a FY08E P/E of less than 10x and an FY08E dividend yield of over 5% (based on a 60% payout ratio) despite the recent share price rise.