Utilities in East and West: Safe haven in stormy times

Back

23.04.2009

- Utilities assessed as safe haven due to solid operating development, stable cash flows and high sector credit ratings
- New bond issues to optimize debt structure; state as guarantor raises credit quality
- Favourites: GDF Suez, Verbund, Fortum and CEZ (solid debt ratios, strong financial profile)

Download [jpg; 212.7 KB]

The economy in the euro zone was severely affected by the global decline in demand. The drop in international demand caused production cuts in the euro zone. Industrial output dropped in January by -16% and in February even by -18.4% (y/y). Sentiment indicators and the economic data do not contain any signs of an end or slowdown to the downtrend, and therefore, we expect GDP to shrink in the euro zone by -3.6% in 2009. A longer-lasting downturn of the economy would probably have more influence on industrial gas and electricity consumption. We still expect a moderate recovery in 2010.

Central and Eastern Europe – just like the entire world – is in the midst of an economic contraction. However, the extent and causes of the economic down swing vary widely within the region. Countries with a high exporting share are suffering more, because global demand for goods has declined steeply. Any recovery would be closely related to developments in Euroland. It is only in the second half of the year we expect stabilization, however in 2010, the subsequent recovery of Central and Eastern Europe might be faster than in Euroland, as it would receive additional support from the massive upside potential in productivity versus West European countries. This gap is the starting point for the higher economic growth rates in Central and Eastern Europe over the long term. However, we will not see a return to a boom phase in the entire region like from 2005 to 2007 any time soon.

Download [jpg; 1022.9 KB]

The current plunge of the global economy is shifting the attention of investors increasingly towards defensive stocks. Due to the low degree of cyclicity (inelastic demand), a feature of the utility sector is a stable operating business. The solid operating development, stable cash flows and high sector credit ratings have helped utilities gain the status of "safe havens". The balanced business risk profiles of most companies highlight this feature. The liquidity profile of the sector is stable, and moreover, most companies have sufficient credit facilities at their disposal. In CEE and in Southern Europe (France and Spain), the state also holds large shares in the utility groups, usually acts as guarantor for long-term debt and contributes positively to the credit quality of the companies. Although the companies have to adjust to fluctuations in demand from industry, private consumption is generally not elastic.

The sector currently has an average long-term rating of "A2", which is in the upper medium range of the rating scale and is rated relatively higher than most other sectors. Due to the difficult conditions on the capital markets, utilities are interested in obtaining the best ratings possible[1] to make access to credit markets easier. The new bond issues[2] were used in most cases to optimize the term structure of debt which had been relatively short at some companies.

The integration of the gas and electricity business, and the geographic diversification are the most important motivations for consolidation. In this kind of enviroment, attractively priced industry players become enticing takeover candidates. "We expect the management of the groups to be more selective in their investment decisions than in the past years. Otherwise, an excessively aggressive expansion (with high leverage[3]) would put the ratings of the companies at risk," said Alihan Karadagoglu, Credit Analyst at Erste Group.

Long term, the analysts of Erste Group expect higher oil and gas prices due to the postponed investments in the energy sector (upstream area – exploration & production). "We expect the supply side to dominate the further trend of prices for primary energy sources and consequently of electricity prices: Utilities that have a better cost structure or whose costs do not depend on the development of prices of primary energy sources should be able to generate higher margins in the future (Verbund and Fortum)," according to Karadagoglu.

"For 'buy-and-hold' investors, utilities are a core investment. Therefore, fundamentally we have a preference for GDF Suez, Verbund, Fortum and CEZ that have solid debt ratios and a strong financial profile. Measured by EBITDA margins, CEZ, Fortum and Verbund are very profitable. Only when markets calm lastingly would it become feasible for utilities to underperform other cyclical industries," stated Elena Statelov, Credit Analyst at Erste Group.

Relevant credit ratios in a peer group comparison

	Einstufung Erste Bank Research	Moody's Rating	Umsatz in € Mio.	CAGR*	EBITDA Marge	Gearing**	Nettoversch. /Ebitda	Interest cover 1*	Interest cover 2*
E.ON	stabil	A2 stabil	86.753	15,4%	15,4%	108,7%	2,6x	4,4x	5,9x
GDF Suez ***	leicht positiv	Aa3 stabil	83.053	30,8%	16,7%	51,8%	2,2x	5,8x	9,4x
Electricite de France	leicht negativ	Aa3 stabil	64.279	6,6%	22,2%	155,7%	2,7x	4,8x	8,6x
ENEL***	leicht negativ	A2 neg	61.184	15,8%	23,4%	207,3%	3,8x	2,9x	4,4x
RWE	leicht negativ	A1 Watchlist neg	47.500	3,0%	17,5%	38,8%	0,5x	6,1x	8,6x
Veolia	negativ	A3 neg	36.206	10,0%	11,7%	172,0%	3,9x	1,7x	3,8x
Iberdrola	leicht negativ	A3 stabil	25.196	23,9%	25,5%	120,9%	4,4x	2,9x	4,3x
Endesa	stabil	A3 neg	21.720	10,3%	31,7%	81,3%	2,8x	4,2x	5,6x
Energie Baden Warttemb'	stabil	A2 stabil	16.305	12,3%	15,9%	34,5%	0,6x	6,5x	9,4x
EDP Energias de Portugal	negativ	A2 neg	13.894	13,3%	22,7%	218,2%	4,4x	2,7x	4,4x
CEZ	leicht positiv	A2 stabil	6.766	12,0%	48,0%	18,4%	0,4x	12,6x	16,9x
Fortum	leicht positiv	A2 stabil	5.636	8,0%	44,0%	68,1%	2,2x	5,3x	6,7x
Verbund	leicht positiv	A1 stabil	3.745	4,0%	35,3%	98,2%	2,1x	6,9x	8,8x
EVN	negativ	A1 Watchlist neg	2.397	14,7%	15,1%	43,4%	3,6x	0,6x	1,3x
Mittelwert				12,9%	24,7%	107,0%	2,5x	4,8x	7,8x
Median				12,2%	22,5%	98,2%	2,4x	4,6x	6,3x

*) Compound Annual Growth Rate von 2004 bis 2008, ***) CAGR durch Akquisitionen verzehrt, **) Nettoverschuldung/EK,
1*) EBIT/Zinsaufwendungen, 2*) EBITDA/Zinsaufwendungen
Quelle: Erste Bank Research, Bloomberg

Digression: High investment intensity due to globally rising demand for electricity

The utility sector is an investment intensive industry – and will remain one – due to the globally rising demand for energy. According to the energy report of the European Union for 2007, demand for electricity is increasing at a rate of 1.5% annually in the EU. Total demand for electricity of the EU27 countries was around 3,000 TWh in 2007. Germany reported the highest consumption with 567 TWh, followed by France, Great Britain and Italy. The overall demand expected until 2020 will probably rise by 27%, with Southeast and East European countries posting the steepest increase in demand for electricity.

Accordingly, the long-term production and supply of electricity have to be expanded and renewed. In this respect, the European Commission expects a volume of EUR 900bn in investments to be needed in the coming 25 years. This projection and the medium-term investment plans of European utility groups are also clear indications of the investment intensity of the sector.

Medium-term investment programs of selected European utilities

CEZ	CZK 340 Mrd. (EUR 12,5 Mrd) werden zwischen 2009-2013 für Capex vorgesehen. Großteil davon entfällt auf Stromerzeugung (u.a. Braunkohlekraftwerk in CZ, Windpark in RO) und Vertrieb.
Enel	EUR 33 Mrd. (2009-2013) werden zu 52% für Wachstum und 48% für Erhalt des bestehendes Geschäfts vorgesehen.
E.ON	EUR 30 Mrd. (2009-2011) werden zu 68% für Wachstum und 32% für Erhalt des bestehendes Geschäfts vorgesehen.
GDF Suez	Das EUR 30 Mrd. schwere Programm (2008-2010) zielt auf organisches Wachstum und Erhalt des bestehenden Geschäfts.
Iberdrola	Das EUR 24 Mrd. schwere Investitionsprogramm (2008-2010) umfasst auch die abgeschlossene Übernahme von East Energy. 2009 werden Capex-Ausgaben von EUR 4,2 Mrd. erwartet (-44% j/j).
RWE	Das EUR 26 Mrd. Investitionsprogramm bis Ende 2012 wird auf jährlich EUR 6,5 Mrd. aufgeteilt. 50% organisches Wachtum soll dabei erreicht werden.
Verbund	Geplant ist ein Capex-Programm in Höhe von EUR 2,8 Mrd. bis 2015. 40% davon werden für Ausbau der Übertragungsnetze in Österreich verwendet.

Quelle: Geschäftsberichte; Erste Bank Research

[1] Most companies in the industry have sound credit profiles and solid investment-grade ratings. Due to their extensive investment programmes, only EVN and RWE are on the negative watchlist.

[2] In 1Q 2009, most utilities successfully floated bonds with a volume of EUR 26bn (re-financing needs of the industry around EUR 16bn in 2009). This corresponds to one-quarter of total issuing volume on the EUR primary market.

[3] Leverage = Investment programme financed with debt and very extensive M&A transactions.

The full report [pdf; 588.3 KB]

Back