Equity Research

COMMERZBANK

Quick Bite

13 January 2010

E.ON

GIS feedback – Confidence despite a difficult gas market

E.ON management appeared confident that profitability at its Pan European Gas division will start to recover from 2011 based on a stepwise recovery of the gas market and a likely positive outcome of current price adjustment negotiations with producers. Visibility on E.ON's power production operations appears high for 2010 thanks to the company's forward selling strategy. A well-diversified portfolio across regions and technologies helps the company to reduce political pressure and CO_2 costs.

Confidence on recovering gas profits E.ON management appeared confident that from 2011, profitability at E.ON Pan European Gas will start to recover progressively as a result of price adjustments that the company is targeting in current negotiations with gas producers. Slow, stepwise recovery in industrial gas demand and rising earnings contributions from E.ON's upstream gas operations should also help.

Good visibility on power generation profits E.ON has already sold forward more than 90% of its German power production in 2010, and more than 80% of its production in 2011. Visibility for E.ON's power generation earnings appears high and E.ON management confirmed that the company should still benefit from a positive price effect in 2010. From 2011, generation profits are likely to weaken on a negative power price trend.

We maintain our Hold recommendation and price target of €30 as we believe that sentiment for the shares might remain weak, with low visibility on E.ON's gas operations and a low gas price environment.

We consider E.ON shares fairly valued at €33/share based on our sum-of-the parts and DCF valuations assuming power, fuel and CO_2 prices of €66 (base-load), \$80/t (coal), €24/MWh (gas) and €24/t (CO2) from 2014.

Potential extension of nuclear life time A decision on a longer life for E.ON's oldest nuclear power plants could boost our fair value estimate by €1/share. We expect a decision on the future of Germany's nuclear power plants by October this year, when the German government plans to present its new energy concept.

Key Data

Year-end Dec	2008	2009E	2010E	2011E	2012E	2013E
Sales adj. (€m)	86,753	80,247	82,494	82,119	80,908	83,873
EBITDA adj. (€m)	13,384	13,315	13,744	14,133	13,920	14,164
EBITA adj. (€m)	9,878	9,915	10,219	10,425	10,166	10,411
EBITA margin	11.4%	12.4%	12.4%	12.7%	12.6%	12.4%
FCF pre-div (€m)	(10,100)	2,694	883	5,549	4,765	5,476
FCF margin	(11.6%)	3.4%	1.1%	6.8%	5.9%	6.5%
EPS rep. (€)	3.01	2.78	3.04	3.07	3.02	3.14
EPS adj. (€)	3.08	3.17	3.04	3.07	3.02	3.14
DPS (€)	1.50	1.50	1.70	1.70	1.70	1.80
EV/Sales (x)	1.3	1.2	1.2	1.2	1.2	1.1
EV/EBITDA (x)	8.7	7.4	7.3	7.0	7.0	6.7
EV/EBITA (x)	11.8	9.9	9.8	9.4	9.5	9.1
P/E (x)	12.5	9.1	9.5	9.4	9.6	9.2
Div yield	3.9%	5.2%	5.9%	5.9%	5.9%	6.2%
Gearing (x)	1.2	1.1	1.0	1.0	0.9	0.8
Net debt/EBITDA (x)	3.5	3.4	3.4	3.2	3.2	3.0

Source: Company, Commerzbank Corporates & Markets

Hold

TP €30

CP €28.87

(Close 12 January 2010)

Expected performance	3.9%
Volatility	35.6%
Risk-adjusted performance	0.2
Bloomberg / Reuters:	EOAN GY, EONGn.DE
Market cap (€m)	54,984
EV (€m)	100,266
Shares outstanding (m)	1,905
Free float	n.a.
Dly trading vol (last 3-mth) (€m)	208
Sales CAGR 2010-13E	0.6%
EBITDA CAGR 2010-13E	1.0%
EBITA CAGR 2010-13E	0.6%
EPS CAGR 2010-13E	1.1%

Changes in estimates

€m	2009o	2009n	2010o	2010n
Sales	83,778	80,247	86,345	82,494
EBITA	10,023	9,915	10,455	10,219
EPS (€)	2.87	3.17	3.13	3.04

Source: Commerzbank Corporates & Markets

Relative and absolute performance

Source: Bloomberg

Next news event:

Major shareholders:

Sources: Bloomberg, Commerzbank Corporates & Markets, Company data

Analyst

Tanja Markloff

+44 207 475 3397

Tanja.Markloff@commerzbank.com

cbcm.commerzbank.com

For important disclosure information please see pages 6 and 7

Confidence despite difficult gas market

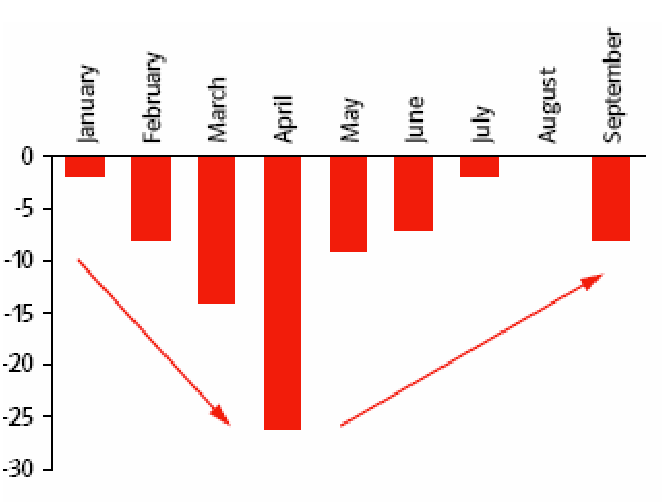
Confidence on recovering gas profits

Low industrial gas demand resulting from the economic downturn and higher availability of LNG led to oversupply in the European gas market, and to a situation in which gas customers can buy gas at European trading hubs (e.g. TTF) below the oil-price linked import price (BAFA) charged to importers as part of their long-term take-or-pay contracts. Reduced sales volumes and margin pressure reduced EBIT at E.ON's second largest market unit Pan European Gas by c. 33% in the first nine months last year.

E.ON management expects 2010 to remain a difficult year for its gas operations but appears confident that from 2011 profitability will start to recover as a result of price adjustments that the company is targeting in current negotiations with gas producers. Slow, stepwise recovery in industrial gas demand and rising earnings contributions from E.ON's upstream gas operations should also help.

Our earnings estimates take into account a potential decline in EBIT at E.ON Pan European Gas of 30% in 2009 and 18% in 2010 based on lower sales volumes and margins and the de-consolidation of Thuega (2010). From 2011 we take into account a potential stepwise recovery of margins and volumes.

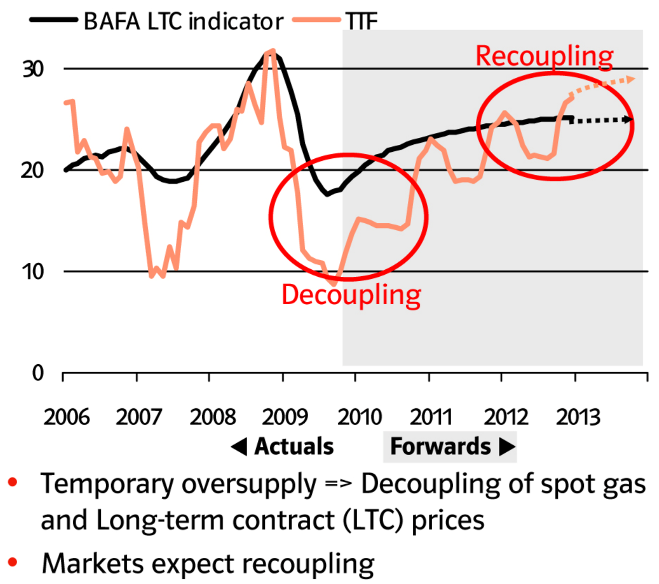
CHART 1: **Economic recession dragging down gas demand**



Source: E.ON, Commerzbank Corporates & Markets

**) Decline in Gas demand in D, UK, I, F, NL, E*

CHART 2: **TTF spot price decoupled from BAFA price**



Source: E.ON, Commerzbank Corporates & Markets

Good visibility on power generation profits in 2010

Visibility appears high for E.ON's power production earnings and the company will still benefit from an improvement in the average achieved price in 2010 (E.ON guidance c. 400m vs 2009). From 2011, we expect a negative impact on E.ON's power generation business from the continued negative power price trend since 2008.

E.ON said that the company had sold forward more than 90% of its German power production in 2010 and more than 80% in 2011.

TABLE 1: **Average power, fuel and CO_2 prices in line with E.ON's forward selling, market statistics, long-term estimates**

E.ON		2008	2009	2010	2011	2012	2013	2014
Forward selling as of October 31		>90%	>90%	>80%				
German base-load	€/MWh	57	59.0	62.5	60	54.2	58.6	66.0
German peak-load	€/MWh	80	85.5	85.8	87	76.8	81.0	80.6
German coal	€/t	56	68.5	71.8	78.9	72.5	72.5	59.3
German gas	€/MWh	23	24.5	25.1	25.1	22.1	21.9	24.3
CO_2	€/t	22	20.5	19.9	15.3	14.4	16.0	24.0

Source: Commerzbank Corporates & Markets

Weak power and gas price trend burden sentiment for the shares

The continued weak trend in forward power and gas prices burden sentiment on E.ON shares in our view.

We adjust our earnings forecasts marginally for 2010-13, taking into account recent energy and CO_2 price developments. We maintain our long-term power price forecast of €66/MWh (base-load), which is in line with the breakeven level of a new gas and coal-fired power plant assuming fuel and CO_2 prices of $80/t (coal), €24/MWh (gas) and €24/t (CO2).

TABLE 2: **E.ON estimates**

€m	2008	2009E	2010E	2011E	2012E	2013E
Adj. EBIT	9878	9915	10219	10425	10166	10411
Old		10023	10455	10226	10162	10731
% change		*-1%*	*-2%*	*2%*	*0%*	*-3%*
Consensus		9918	10307	10438	10791	10731
E.ON outlook 2009:		~9878				
Net income (adjusted)	5598	5301	5792	5851	5749	5982
Old		5309	5960	5931	5939	6420
% change		*0%*	*-3%*	*-1%*	*-3%*	*-7%*
Consensus		5440	5565	5705	6005	5916
E.ON outlook:		~-3 to -5% below 2008 level				
EPS adjusted (€)	3.01	2.78	3.04	3.07	3.02	3.14
Old		2.79	3.13	3.11	3.12	3.37
% change		*0%*	*-3%*	*-1%*	*-3%*	*-7%*
Consensus		2.84	2.93	3.02	3.13	3.15
E.ON outlook 2009:		~-3 to -5% below 2008 level				
Dividend per share (€)	1.50	1.50	1.70	1.70	1.70	1.80
Old		1.53	1.72	1.71	1.71	1.85
% change		*-2%*	*-1%*	*-1%*	*-1%*	*-3%*
Consensus		1.50	1.57	1.65	1.71	1.78
E.ON outlook: 50% to 60% of adj. EPS						

Source: Commerzbank Corporates & Markets

We consider E.ON shares fairly valued at €33 We consider E.ON shares fairly valued at €33 per share based on our sum-of the parts and DCF valuations. We apply a 10% discount to our fair value estimate to derive our price target for the shares for the next six months as we believe sentiment for the shares will remain low without positive news on power and gas prices.

TABLE 3: **E.ON sum-of-the-parts valuation**

				EV/EBITDA		
E.ON: Market unit	**Value (€m)**			**2010E**	**2011E**	**2012E**
Central Europe	45,799	DCF	(WACC 6,3% after tax, g:2%)	6.2	6.5	7.1
Pan European Gas	24,640	DCF	(WACC 6,3% after tax, g:2%)	12.5	11.8	11.2
UK	8,931	DCF	(WACC 6,3% after tax, g:2%)	11.2	11.5	10.4
Nordic	4,893	DCF	(WACC 6,3% after tax, g:2%)	5.3	5.4	5.6
US electricity	4,837	DCF	(WACC 5,6% after tax, g:2%)	8.6	7.7	7.6
Energy Trading	4,543	7.0	xEBITDA 2009-11 average			
Climate & Renewables	3,633		(WACC 6,3% after tax, g:2%)	8.6	6.4	6.4
OGK-4	3,188		(WACC 10.9% after tax, g:2%)	13.0	6.2	5.3
Italy	5,721	DCF	(WACC 7.4% after tax, g:2%)	7.0	6.5	6.2
Spain	3,008	DCF	(WACC 7.4% after tax, g:2%)	13.2	9.8	8.3
Capitalized holding cost	-1,470	7.0	x EV/EBITDA09e	7.0	7.0	7.0
Total	**107,723**					
Pension provisions	-3,559		Expected book value atf Dec. 2010			
Nuclear provisions	-13,357		Expected book value at Dec. 2010			
Mining provisions	-1,483		Expected book value at Dec. 2010			
Net cash (debt)	-30,281		Expected book value at Dec. 2010			
Financial assets	7,953					
. 3,5% Gazprom at market value	*3,817*					
Minorities E.ON	-3,320	10.0	xP/E 2010e			
Total SOTP value	**63,676**					
Number of shares (m)	1,905					
Value per share (€)	**33**					

Source: Commerzbank Corporates & Markets

TABLE 4: **Financials**

Balance Sheet (€m)	**2009E**	**2010E**	**2011E**	**2012E**	**2013E**	**CAGR 2010-13E**
Property, plant & equipment	60,427	65,892	66,933	68,215	69,003	1.5%
Intangible fixed assets	6,749	6,749	6,749	6,749	6,749	0.0%
Goodwill	16,555	16,443	16,233	16,233	16,233	
Total operating fixed assets	**83,730**	**89,083**	**89,915**	**91,196**	**91,985**	**1.1%**
Net working capital	(7,471)	(7,471)	(7,471)	(7,471)	(7,471)	0.0%
as a % of sales	(9.3%)	(9.1%)	(9.1%)	(9.2%)	(8.9%)	
Operating invested capital	76,259	81,612	82,444	83,725	84,514	1.2%
ROIC (%)	9.2%	9.1%	8.9%	8.6%	8.7%	
IC/sales (x)	1.0	1.0	1.0	1.0	1.0	
Investments	19,052	18,940	18,730	18,730	18,730	(0.4%)
Capital employed	**95,311**	**100,552**	**101,173**	**102,455**	**103,243**	**0.9%**
ROCE	**7.3%**	**7.3%**	**7.2%**	**7.0%**	**7.1%**	
Cash and cash equivalents	8,742	9,352	11,227	12,296	15,052	17.2%
Interest-bearing liabilities	41,058	44,058	44,058	44,058	45,058	0.8%
Interest-bearing provisions	18,399	18,399	18,399	18,399	18,399	0.0%
Net debt (pre-adjustments)	**50,715**	**53,105**	**51,230**	**50,161**	**48,405**	**(3.0%)**
Total equity	**42,458**	**45,309**	**47,806**	**50,156**	**52,701**	**5.2%**
Equity Ratio	**26.3%**	**27.1%**	**28.1%**	**29.1%**	**30.0%**	
ROE	**15.7%**	**14.0%**	**13.3%**	**12.3%**	**12.2%**	
Total assets	**161,617**	**167,468**	**169,965**	**172,315**	**175,860**	**1.6%**
Income Statement (€m)	**2009E**	**2010E**	**2011E**	**2012E**	**2013E**	**CAGR 2010-13E**
Sales	80,247	82,494	82,119	80,908	83,873	0.6%
growth y-o-y	(7.5%)	2.8%	(0.5%)	(1.5%)	3.7%	
Operating expenses	66,932	68,750	67,986	66,988	69,709	0.5%
EBITDA	13,315	13,744	14,133	13,920	14,164	1.0%
as a % of sales	16.6%	16.7%	17.2%	17.2%	16.9%	
Depreciation and intangible amortisation	3,399	3,525	3,708	3,754	3,753	2.1%
EBITA	**9,915**	**10,219**	**10,425**	**10,166**	**10,411**	**0.6%**
as a % of sales	12.4%	12.4%	12.7%	12.6%	12.4%	
Impairments	n.a.	n.a.	n.a.	n.a.	n.a.	
EBIT	9,915	10,219	10,425	10,166	10,411	
Net interest result	(2,041)	(1,929)	(2,077)	(1,961)	(1,895)	(0.6%)
Result from participations	0.0	0.0	0.0	0.0	0.0	
Other financial result	0.0	0.0	0.0	0.0	0.0	
Adjustments	2,445	0.0	0.0	0.0	0.0	
PBT	10,319	8,289	8,348	8,205	8,516	0.9%
Tax expense	(2,951)	(2,166)	(2,177)	(2,159)	(2,252)	1.3%
Adjustment	(1,017)	0.0	0.0	0.0	0.0	
Tax rate	18.7%	26.1%	26.1%	26.3%	26.4%	
Net profit from continuing operations	6,351	6,124	6,171	6,046	6,264	0.8%
as a % of sales	7.9%	7.4%	7.5%	7.5%	7.5%	
Minorities	(309)	(332)	(320)	(297)	(282)	
Net income attributable to shareholders	**5,893**	**5,792**	**5,851**	**5,749**	**5,982**	**1.1%**
Cash Flow Statement (€m)	**2009E**	**2010E**	**2011E**	**2012E**	**2013E**	**CAGR 2010-13E**
Operating cash flow	**7,185**	**9,649**	**9,878**	**9,800**	**10,017**	**1.3%**
as a % of sales	9.0%	11.7%	12.0%	12.1%	11.9%	
Gross capex	(8,567)	(9,514)	(5,729)	(5,036)	(4,541)	(21.9%)
Asset disposals	4,075	748	1,400	0.0	0.0	
Net financial investments	0.0	0.0	0.0	0.0	0.0	
Net acquisitions	0.0	0.0	0.0	0.0	0.0	
Gross capex as a % of sales	10.7%	11.5%	7.0%	6.2%	5.4%	
Gross capex as a % of depreciation	252.0%	269.9%	154.5%	134.1%	121.0%	
Free cash flow	**2,694**	**883**	**5,549**	**4,765**	**5,476**	**83.7%**
as a % of sales	3.4%	1.1%	6.8%	5.9%	6.5%	
Dividends	(2,793)	(2,857)	(3,238)	(3,238)	(3,238)	
Free cash flow (post dividend)	**(495)**	**(2,390)**	**1,875**	**1,069**	**1,757**	
Increase / (decrease) in debt	0.0	3,000	0.0	0.0	1,000	
Increase / (decrease) in equity	0.0	0.0	0.0	0.0	0.0	
Other financing cash flows	0.0	0.0	0.0	0.0	0.0	
FX effects	0.0	0.0	0.0	0.0	0.0	
Other items	0.0	0.0	0.0	0.0	0.0	
Change in cash	**(495)**	**610**	**1,875**	**1,069**	**2,757**	

Source: Commerzbank Corporates & Markets

E.ON price chart

Source: Commerzbank Corporates & Markets

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Frankfurt	**London**	**New York**
Commerzbank AG	Commerzbank AG London Branch	Commerzbank Capital Markets Corp.
DLZ - Gebäude 2, Händlerhaus Mainzer Landstraße 153 60327 Frankfurt	PO BOX 52715 30 Gresham Street London, EC2P 2XY Tel: + 44 207 623 8000	2 World Financial Center, 31 st floor, New York, NY 10020-1050 Tel: + 1 212 703 4000 Fax: + 1 212 703 4201