

Underlying volumes remain weak

Demand remains weak

Total UK gas demand fell by a further 6% y-y during Q1 2012, driven mainly by above-average temperatures, and lower gas-fired power generation. Energy efficiency continues to erode underlying demand, driving the c1% fall in overall power volumes during the quarter. We expect Q1 residential UK gas and electricity volumes to have fallen by c4% and 2% respectively, and although Q2 has been colder so far, the underlying demand trends highlight the challenges for suppliers such as Centrica and SSE.

Supply regulation - not out of the woods yet

Regulatory and political scrutiny of the big six energy suppliers remains intense, and a recent meeting with Ofgem galvanised our belief that risks remain on the downside. Notwithstanding recent attempts to self regulate, the conclusions of the Retail Market Review due in June/July could force the companies to go even further or face a referral to the Competition Commission. SSE has made the most effort to appease the regulator and appears relatively well placed, but we think it will remain difficult for the industry to grow supply profits for the foreseeable future.

Generation market polarised

Unsurprisingly, output from gas-fired power plant fell by c30% in Q1(y-y), reflecting weak spark spreads. Coal-fired output, increased by 19% as dark spreads remained robust. Nuclear output fell by 12%, and renewables' contribution increased by 50%. We believe that the bleak outlook for CCGTs could restrain growth in generation earnings for SSE and Centrica during 2012 and remain cautious on both stocks ahead of newsflow (CNA IMS 11th May, SSE results 16th May). We have reduced our PBT/EPS forecasts for SSE by 5% - see "Adjusting The Kilt at FY11/12 Results" for details. Higher dark spreads are positive for Drax, although it remains a binary call on biomass subsidies (due this month).

Last month : UK UTILS +3.3%, PE UTILS -2.6%

During the last four weeks, the UK Utilities (+3.3%) outperformed the pan-European sector by 5.8% and the FTSE-100 by 7.1%. SVT was the star (+8.4%) on hopes of value return and M&A. At the other end of the scale, SSE fell 0.2%.

Last month : Commodities weak

Gas forwards continued to retreat during the last 30 days, eroding YTD gains to 4% (highs >10%). Power was also weak, with 2013 baseload falling 4% to slightly lower than the 2012 starting point. Lower coal prices (-7%) continued to support near term dark spreads, although the carbon price floor has a significant negative effect further along the curve. Baseload spark spreads remain sub £1/MWh, with overcapacity still dwarfing the impact of recently announced plant closures.

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Table 1: UK Utilities Calendar - May 2012

Date	Event	Date	Event
Fri 11	CNA IMS/AGM	Wed 23	IPR - xd €6.6c
Tue 15	Drax - IMS	Thur 24	UU - FY results
Wed 16	SSE-FY results	Tue 29	PNN-FY results
Thur 17	NG, Shanks - FY results	Wed 30	SVT - FY results NG - xd

Table 2: M Performance

Top 3	% chg	Mid	% chg	Bot 3	% chg
SVT	8.4%	DRX	4.8%	PNN	3.5%
NG	5.4%			CNA	2.6%
UU	5.0%			SSE	-0.2%
UKUTILS	3.7%			STX600	-3.4%
STXUTILS	-2.1%			FTSE100	-3.5%

Source: Bloomberg, BofA Merrill Lynch Global Research

Source: BofA Merrill Lynch Global Research

Table 3: Power/ Commod Snapshot

	2013	1M (%ch.)	YTD (% Ch.)
UK Base. Elec	50.13	-4.0%	-1.2%
UK CDS (£/MWh)	10.87	5.4%	65.3%
UK CSS (£/MWh)	0.73	-8.0%	-60.1%
Coal (\$/ton)	105.25	-7.7%	-10.7%
Carbon (€/ton)	7.07	-1.8%	-7.0%
NBP (p/therm)	64.68	-4.1%	4.1%

Source: BofA Merrill Lynch Global Research, Bloomberg

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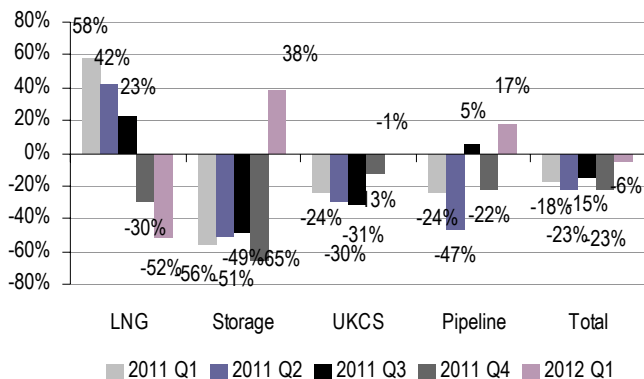
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A weak start to the year for gas volumes

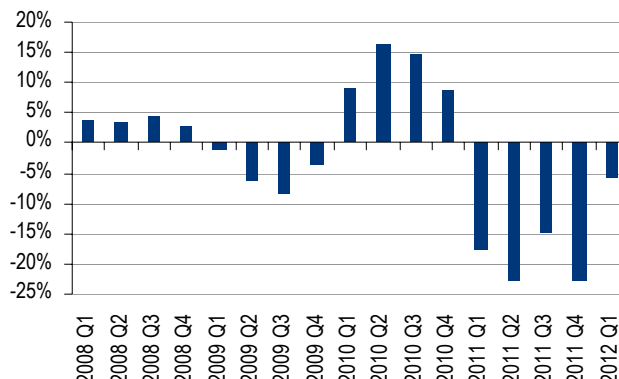
Total UK gas demand fell by 6% during Q1, making it the 5th consecutive quarter of lower volumes. LNG imports were down sharply (-52%), although this was offset by higher pipeline imports and increased storage withdrawals during the February cold snap.

Chart 1: UK gas flows: y-y % change



Source: National Grid data, BofA Merrill Lynch Global Research

Chart 2: Quarterly Y-o-Y Change in the UK Gas Flow



Source: National Grid data, BofA Merrill Lynch Global Research

Residential gas demand - weather and efficiency

The key month of January was 1.6°C warmer than last year, although this was largely offset by a colder February, when average temperatures were 1.2°C lower. March, however, was 1.9°C warmer, resulting in lower heating demand for the quarter as a whole. Note that the shoulder month of April out-turned >4 degrees colder than last year, which was particularly mild.

Table 4: Average Monthly Temperatures (UK, degC)

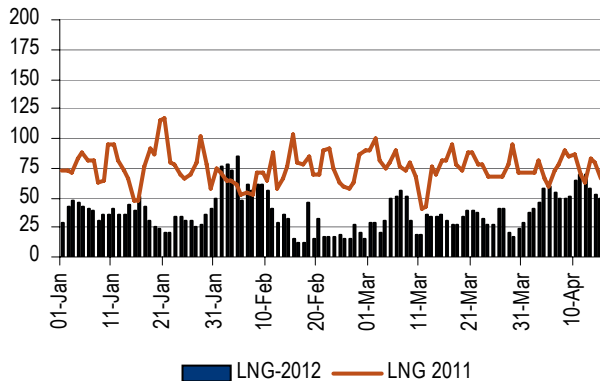
	2012	2011	2010	100 Yr Avg	12 vs 11	12 vs 10	2012 vs Avg
Jan	4.7	3.1	0.9	3.2	1.6	3.8	1.5
Feb	4.1	5.3	1.9	3.4	-1.2	2.2	0.7
Mar	7.7	5.8	5.1	5.0	1.9	2.6	2.7
Apr	6.3	10.7	8.0	7.1	-4.4	-1.7	-0.8
May		11.0	9.8	10.1			
Jun		12.6	14.2	12.8			
Jul		14.1	15.6	14.6			
Aug		14.1	14.2	14.5			
Sep		13.8	12.8	12.4			
Oct		11.2	9.4	9.3			
Nov		8.7	4.3	5.8			
Dec		4.8	-0.9	3.9			

Source: BofA Merrill Lynch Global Research, MetOffice

Gas fired power generation in Q1 was down 30%, and was the single largest impact on gas demand. This was partly offset, however, by higher demand to replenish storage reserves. We assume a modest increase in demand from some business segments, and that the impact of energy efficiency continues to depress household demand. We therefore conclude that residential volumes are likely to have fallen by c4% during Q1.

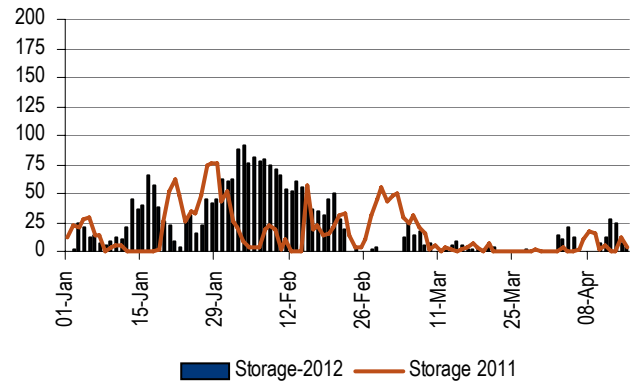
10 May 2012

Chart 3: LNG gas flows (in mcm)



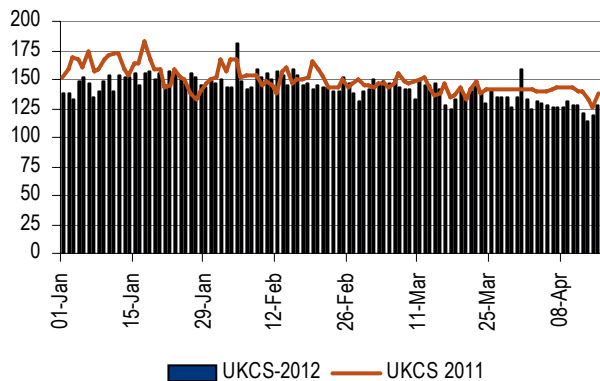
Source: National Grid data, BofA Merrill Lynch Global Research

Chart 4: Storage gas flows (in mcm)



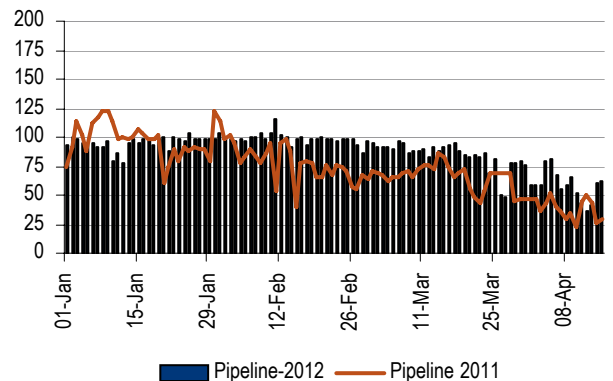
Source: National Grid data, BofA Merrill Lynch Global Research

Chart 5: UKCS gas flows (in mcm)



Source: National Grid data, BofA Merrill Lynch Global Research

Chart 6: Pipeline gas flows (in mcm)



Source: National Grid data, BofA Merrill Lynch Global Research

Power generation - CCGT woes

Electricity generation was down 1% in the first quarter, probably largely driven by additional energy efficiency. Key production trends are a continuing decline in gas-fired output (c30%) resulting from weak overall demand and depressed spark spreads (baseload forwards remain <£1/MWh).

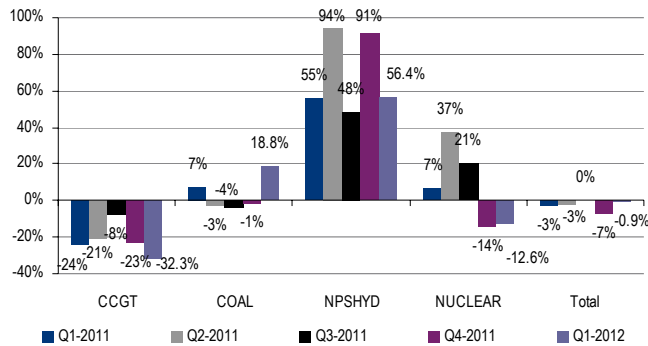
Coal-fired generation, by contrast, was up 19% reflecting robust dark spreads due to higher gas prices, lower carbon/coal prices and the strength of Sterling vs the Euro and US\$. Portfolio generators are bound to have been fuel-switching, but the extent to which this will offset lower CCGT profitability remains to be seen.

Output from renewables and hydro was up sharply due to new capacity additions and wet/windy conditions, particularly in Scotland. SSE has seen a particular benefit during last winter – we believe this was instrumental in meeting its 2011/12 earnings guidance despite overall lower supply volumes.

Nuclear output was down 12%, mainly due to outages at the British Energy fleet.

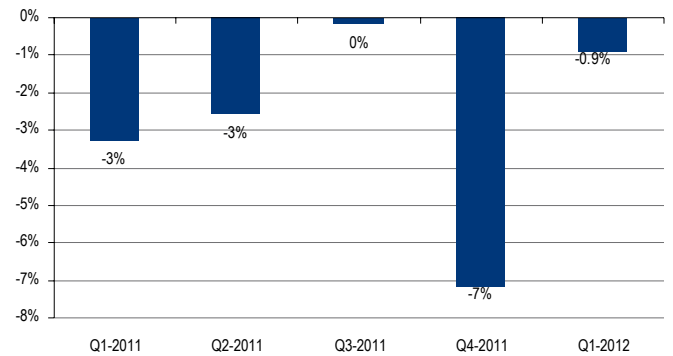
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Chart 7: UK Generation by Fuel Type: y-y % change



Source: National Grid data, BofA Merrill Lynch Global Research

Chart 8: UK generation output, Q1 2012

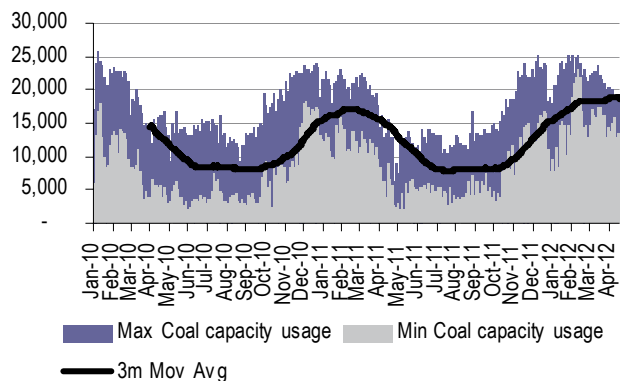


Source: Exelon, BoA Merrill Lynch Global Research

The outlook for spark spreads remains gloomy, reflecting an oversupplied generation market and the likelihood that further energy efficiency will offset most of whatever modest demand growth may transpire.

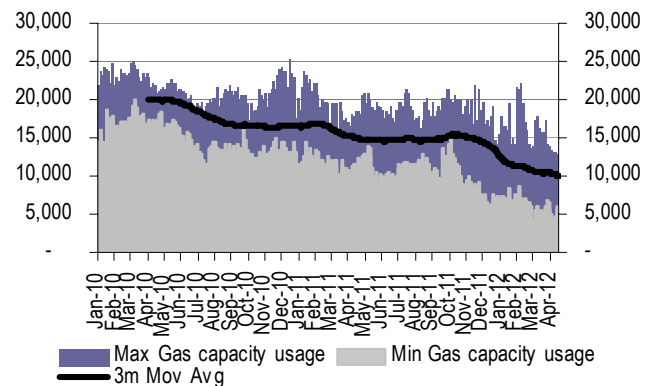
Dark spreads seem well supported short term in the £11-14/MWh range, although the impact of the CO2 floor, particularly from 2015, suggests this strength will be short-lived. Together with the end of free CO2 credits from 2013, it's little surprise that owners of opted-out coal plant are trying to use up their remaining permitted hours well before the end 2015 deadline.

Chart 9: Coal Capacity Usage (in KW)



Source: National Grid data, BofA Merrill Lynch Global Research

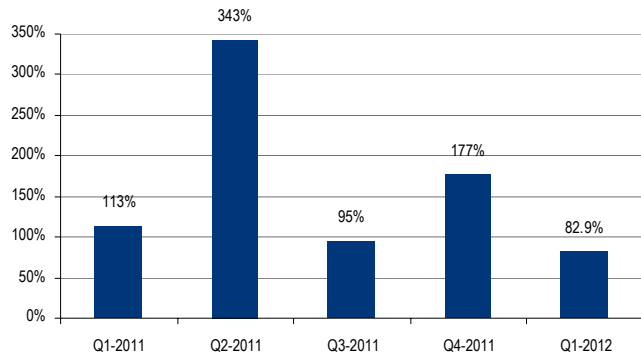
Chart 10: Gas Capacity Usage (in KW)



Source: National Grid data, BofA Merrill Lynch Global Research

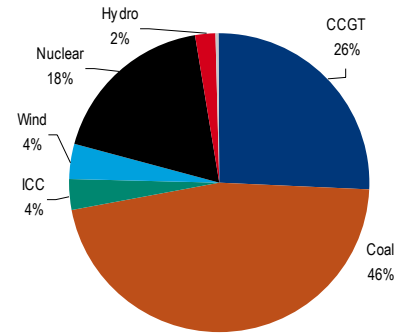
10 May 2012

Chart 11: Wind generation volumes Q1 2012



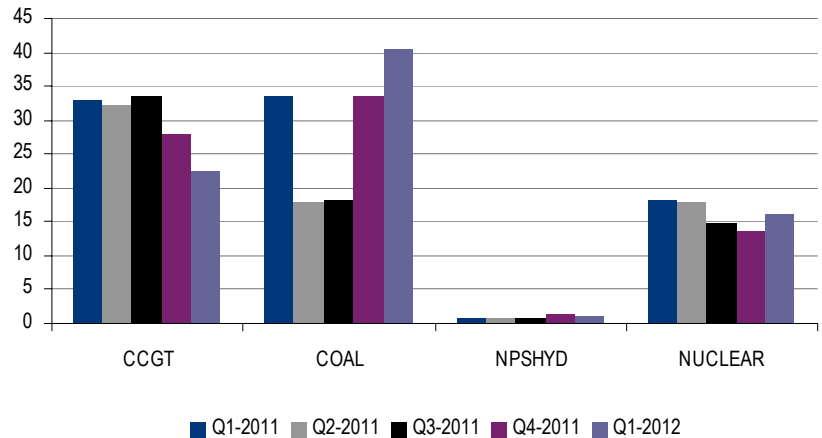
Source: National Grid data, BofA Merrill Lynch Global Research

Chart 12: UK generation by fuel - Q1 2012, %



Source: Exelon, BoA Merrill Lynch Global Research

Chart 13: UK Generation by Fuel Type (in TWh)



Source: National Grid data, BofA Merrill Lynch Global Research

Retail Market Review

Energy supply is an ex-growth business, in our view. There are implicit caps on “acceptable” profitability, public and political perception is low, suppliers have to encourage consumers to use less of the product and make it easier for new entrants to compete, and although compliance costs are increasing rapidly, it can be difficult to reflect this in tariffs.

The ongoing Retail Market Review is nearing its next milestone in June/July, and we believe there is a view in the Market that the suppliers are no longer at risk. We don’t think the sector is quite out of the woods yet, and the final proposals due in June/July could highlight continuing challenges for supply.

A recent meeting with Andrew Wright, head of Markets at Ofgem, confirmed to us that the regulator remains very serious about further reforms and taking action where deemed appropriate.

The story so far

Ofgem published initial the initial conclusions of its Retail Market Review in March 2011. This identified a number of deficiencies in the market structure, the quality of service provided to customers, and set out several workstreams:

- Improve tariff comparability
- Enhance liquidity
- Strengthen previous remedies for both the domestic and non-domestic markets
- Improve reporting transparency.

A number of detailed concepts/proposals have been published since then - responses to the consultations will inform the final proposals due in June/July. These proposals will then be developed into enforceable licence conditions.

Self regulation

Many of the companies have adopted a pro-active approach by introducing reforms even in advance of the final proposals, presumably motivated by public/political image damage limitation and the opportunity to influence the reforms. SSE, for example, has taken the lead in implementing a raft of changes. These have been well received by Ofgem, a sentiment echoed at our recent meeting. SSE seems well placed relative to its peers, but would not be totally immune from the perception of higher risk.

There is a danger that Ofgem may want to go further than the companies have offered – it still has the threat of a Competition Commission referral if the industry doesn't co-operate. This could unsettle investors.

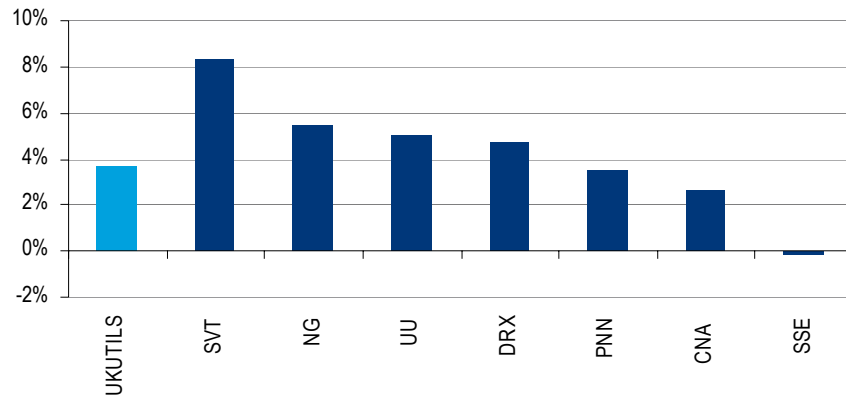
The ultimate objective is to reduce bills for consumers by attracting new entrants – despite not having the advantages of scale, new entrants are exempt from the energy efficiency obligations (worth >£40/customer = 3% of the average bill).

Even if new competitors don't emerge, the costs of complying with Ofgem's remedies are bound to impact on margins, in our view.

Either way, we believe things will get more difficult for the incumbents.

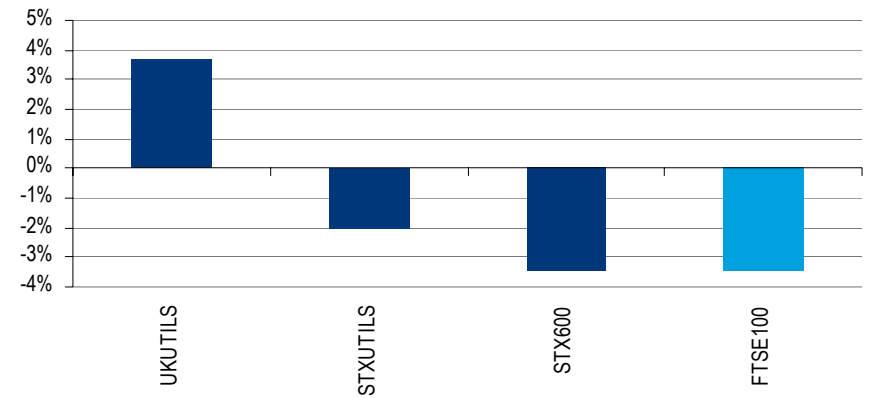
UK - Price performance

Chart 14: 1M Total Return - UK Utilities



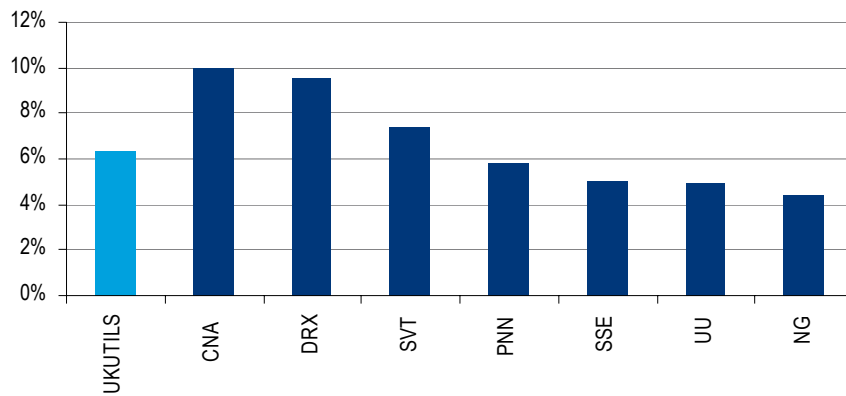
Source: Bloomberg

Chart 15: 1M Performance - European Sectors



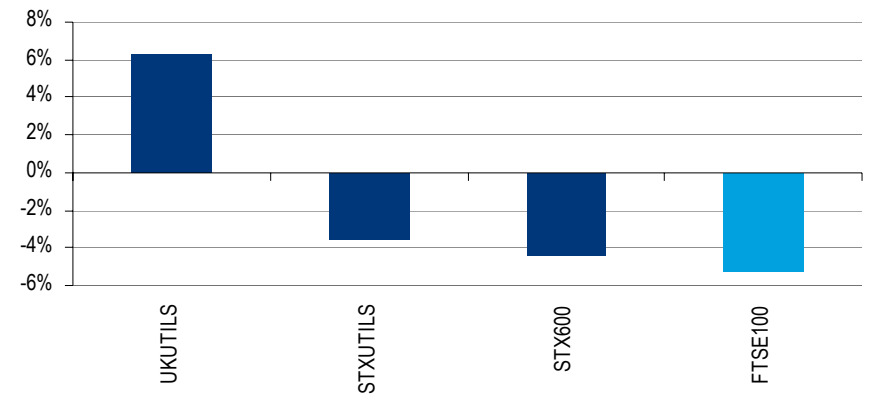
Source: Bloomberg

Chart 16: 3 Monthly Total Return - UK Utilities



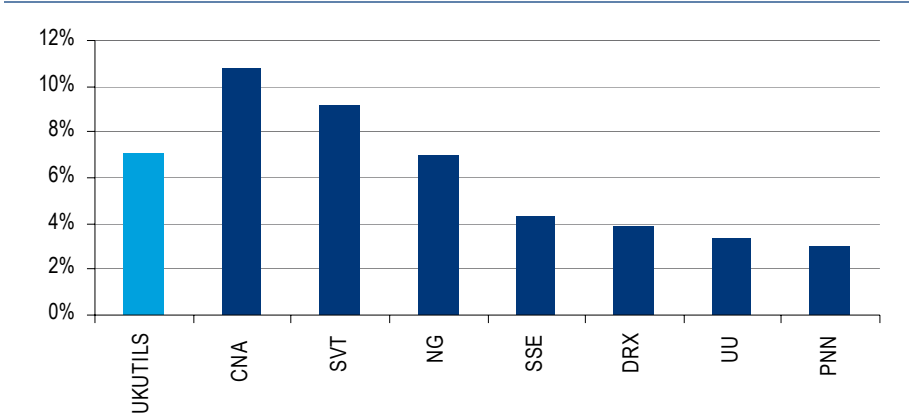
Source: Bloomberg

Chart 17: 3 Monthly Performance - European Sectors



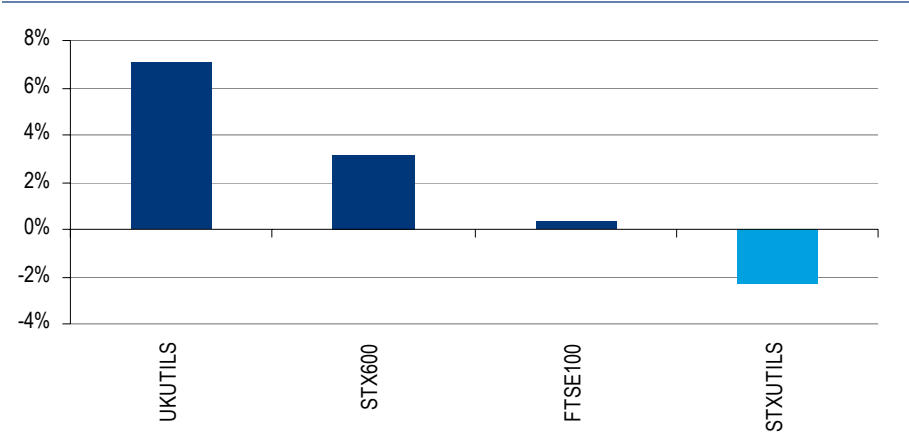
Source: Bloomberg

Chart 18: YTD Total Return - UK Utilities



Source: Bloomberg

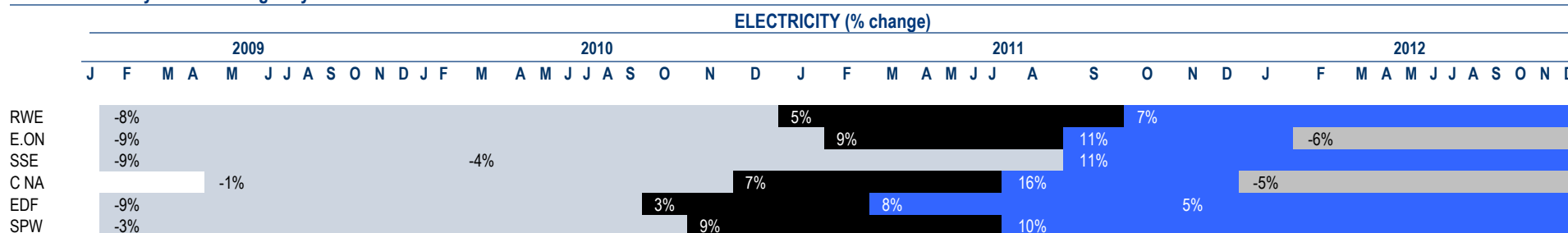
Chart 19: YTD Absolute Performance - European Sectors



Source: Bloomberg

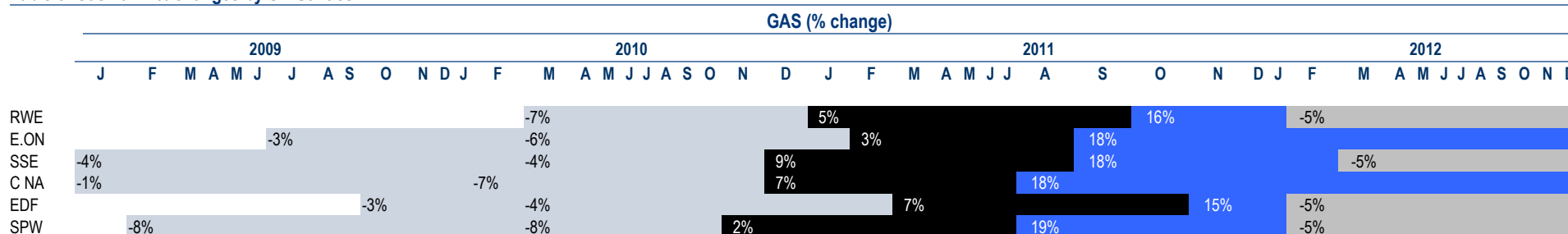
UK Electricity & Gas Tariff Changes

Table 5: Electricity Tariff % changes by UK Utilities



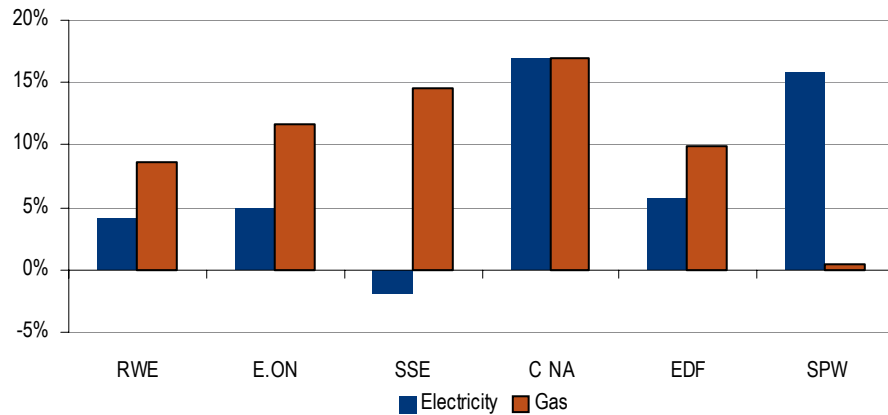
Source: BofA Merrill Lynch Global Research

Table 6: Gas Tariff % changes by UK Utilities



Source: BofA Merrill Lynch Global Research

Chart 20: Net Change in Electricity & Gas Prices by UK Utilities Since Jan 2009



Source: uswitch, BofA Merrill Lynch Global Research

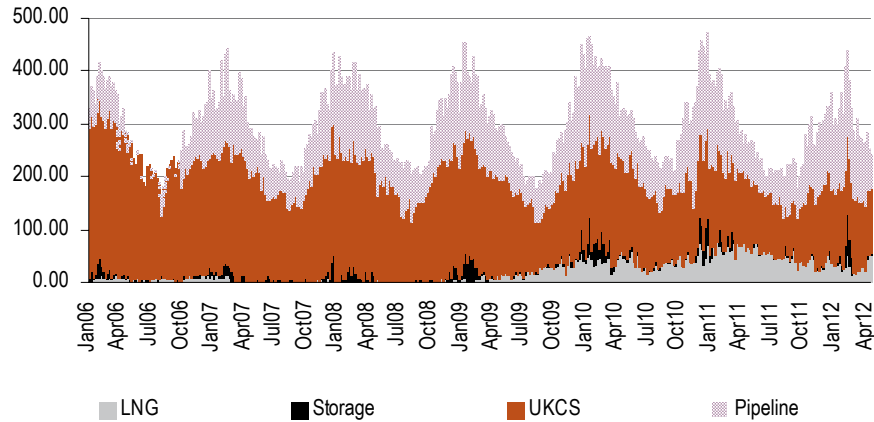
Table 7: Table shows average dual fuel bills for standard plan tariffs (pay on receipt of invoice) across all regions using Ofgem's new definition of a "medium user" (based on a medium user consuming 3,300kWh electricity and 16,500kWh gas a year).

Supplier	Jan-08	Jan-09	Jan-10	Oct-10	Nov-11	Apr-12
British Gas	£821	£1,176	£1,066	£1,030	£1,286	£1,260
EDF Energy	£814	£1,083	£1,061	£1,037	£1,241	£1,203
E.ON	£813	£1,156	£1,095	£1,061	£1,293	£1,260
npower (RWE)	£828	£1,186	£1,150	£1,095	£1,282	£1,243
SSE	£782	£1,118	£1,057	£1,038	£1,265	£1,237
ScottishPower	£853	£1,201	£1,195	£1,152	£1,391	£1,349
Average	£819	£1,153	£1,104	£1,069	£1,293	£1,259

Source: uswitch, BofA Merrill Lynch Global Research

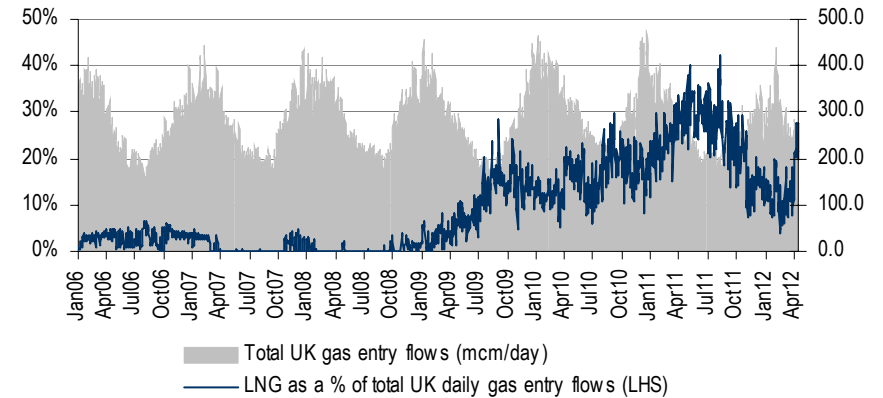
UK Gas Flow

Chart 21: UK Daily Gas entry flows (mcm per day)



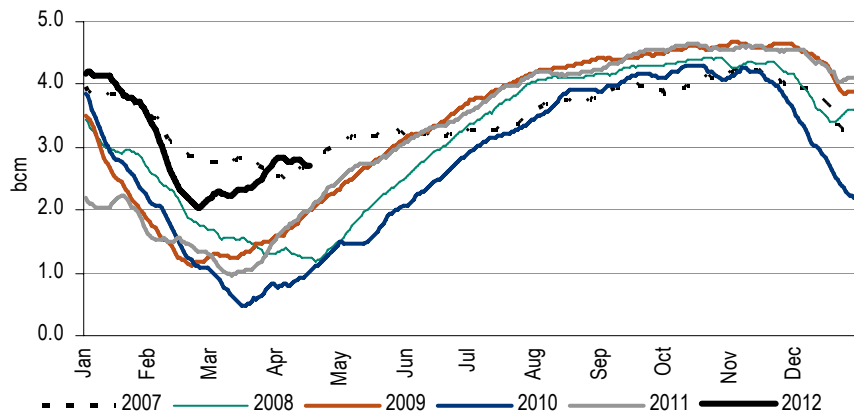
Source: National Grid data, BofA Merrill Lynch Global Research

Chart 22: UK Daily Gas entry flows (mcm per day) and LNG proportion (%)



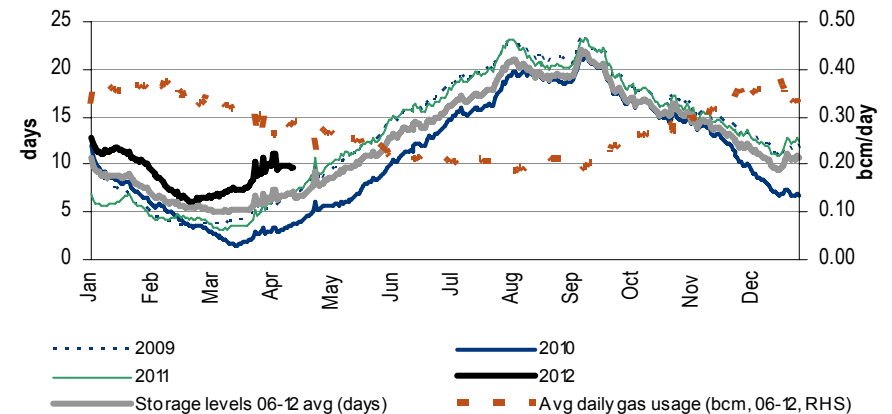
Source: National Grid data, BofA Merrill Lynch Global Research

Chart 23: UK Gas stock levels (bcm)



Source: National Grid Data, BofA Merrill Lynch Global Research

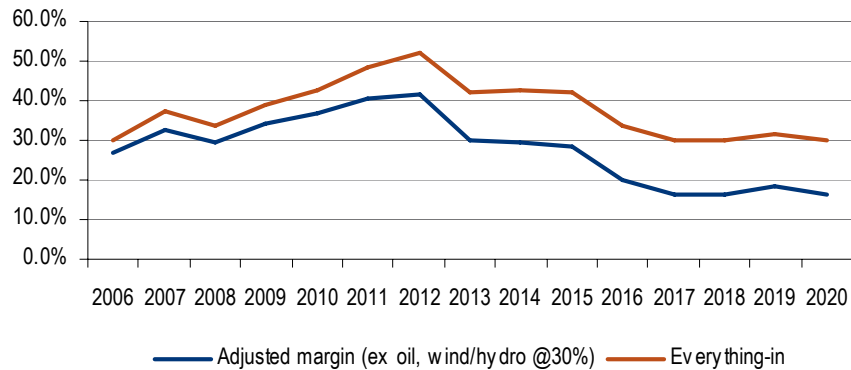
Chart 24: Average storage levels (days, LHS) and Average daily usage (bcm/day, RHS)



Source: National Grid Data, BofA Merrill Lynch Global Research

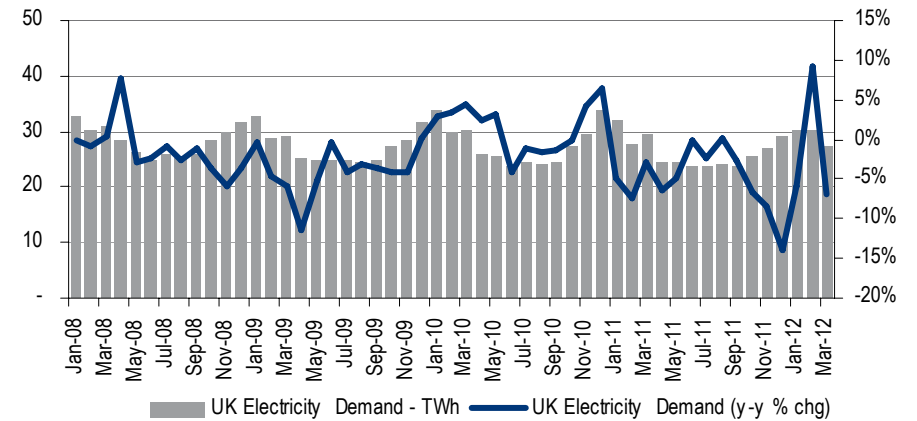
UK Demand, Reserve Margin & Gen Mix

Chart 25: UK generation reserve margin (%)



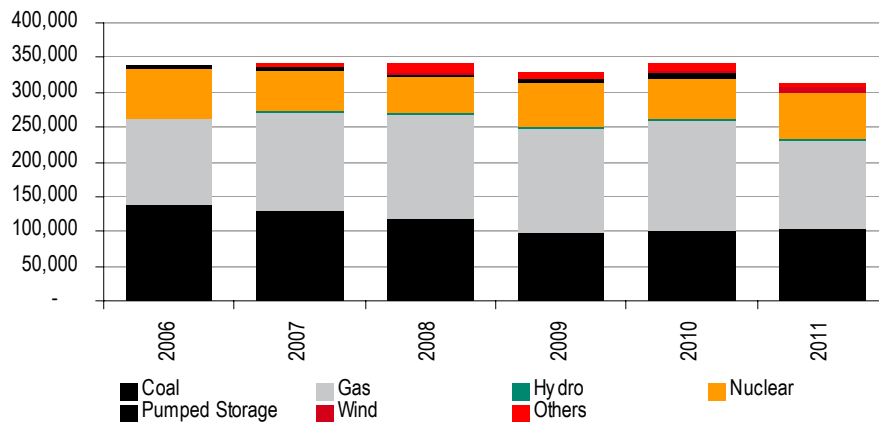
Source : National Grid & BofAML Global Research

Chart 26: UK Monthly Electricity Demand (TWh and % y-y chg)



Source: TSO data, BofA Merrill Lynch Global Research

Chart 27: UK Yearly Generation Mix (Since 2006)



Source: EuroStat, BofAMI Global Research

New Build & Under-construction Generation Capacity

Table 8: Recent/New plant under construction >200MW included in plant margin calculations

Project	Developer	Type	MW	On-line date
Marchwood	SSE/ESB	CCGT	840	2009
Immingham	Conoco	CHP	470	2009
Staythorpe	RWE	CCGT	1650	2010
Grain 2	E.ON	CCGT	1200	2010
Langage	Centrica	CCGT	885	2010
Severn Power	RBS, ING	CCGT	850	2010
Britned interconnector	Ngrid	Interconnector	1300	2011
West Burton	EdF	CCGT	1270	2011
Walney	SSE/Dong	Offshore wind	360	2011
Thanet	Vattenfall	Offshore wind	300	2011
Harestanes	Iberdrola Ren	Onshore wind	213	2011
Griffin	SSE	Onshore wind	205	2011
Pembroke	RWE	CCGT	2000	2012
Greater Gabbard	SSE	Offshore wind	350	2012
Sherringham Shoal	Statkraft	Offshore wind	315	2012
Lincs	Centrica	Offshore wind	270	2012
Thames Estuary	London Array	Offshore wind	630	2013
Clyde	SSE	Onshore wind	350	2013
Rhigos	PYC	Oshore wind	300	2013
Total			13758	

Source: BofA Merrill Lynch Global Research, National Grid, Platts

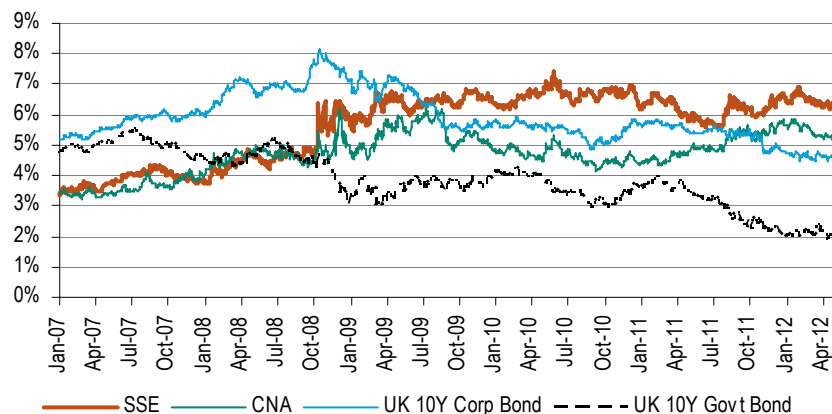
Table 9: Approved gas/coal construction

Location	Developer	Type	Capacity (MW)	Due Date	Status
Barking extention	SSE/EdF/Atco/Balfour	CCGT	470		
Drakelow	E.ON	CCGT	1200		
Teeside	Conoco	CCGT	800		
Kings Lynn B	Centrica	CCGT	800		
Trafford	ESB	CCGT	1520		
Teeside	GdF	CCGT	940		
North Teeside	PX	CCGT	1020		
Hatfield Colliery	Powerfuel	ICGT	900		
Fife Electric	Global Energy	CCGT	400		
Carrington	ESB	CCGT	860		
Total			8910		

Source: BofA Merrill Lynch Global Research, National Grid, Platts

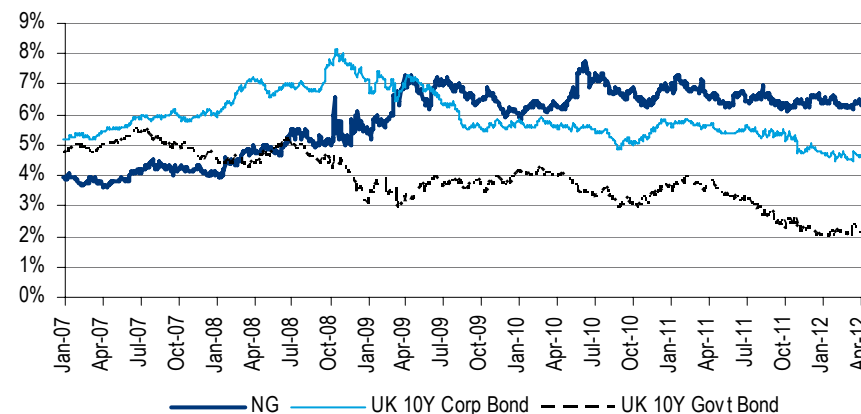
UK - Dividend Yield Performance

Chart 28: Centrica & SSE - FY1DY vs. 10 yr Govt Yield vs. 10 yr Corp Bond



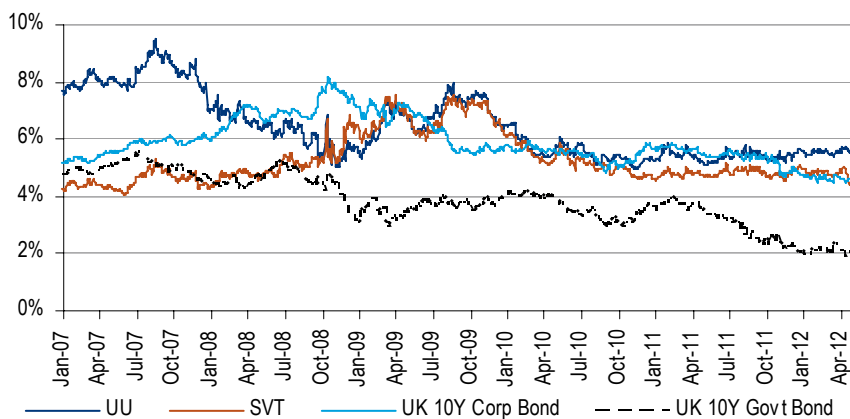
Source: DataStream, BofA Merrill Lynch Global Research

Chart 29: National Grid - FY1DY vs. 10 yr Govt. Bond Yield vs. 10 yr Corp Bond



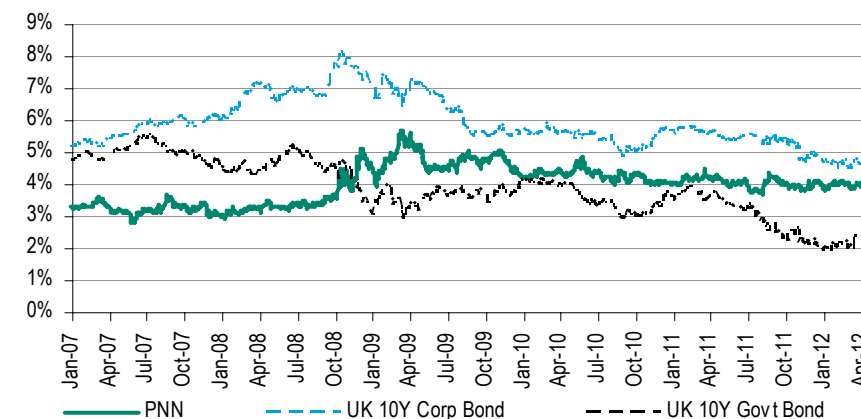
Source: DataStream, BofA Merrill Lynch Global Research

Chart 30: UK Waters - FY1 DY vs.10 yr Govt Bond vs.10 yr Corp Bond



Source: DataStream, BofA Merrill Lynch Global Research

Chart 31: UK Waters - FY1 DY vs.10 yr Govt Bond vs.10 yr Corp Bond



Source: DataStream, BofA Merrill Lynch Global Research

Commodity & power Price Snapshot

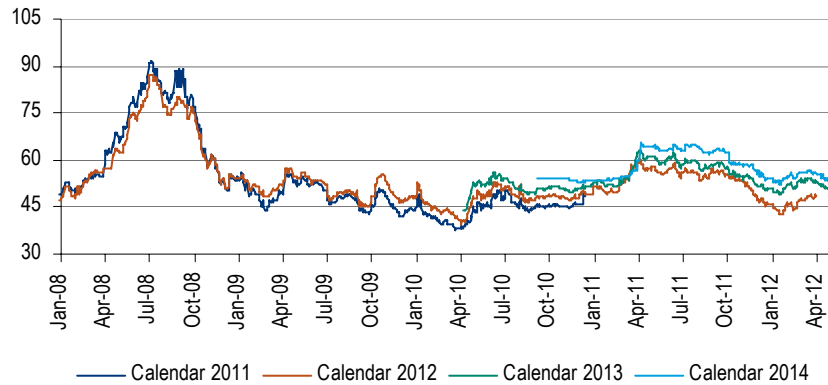
Table 10: Snapshot

		Forward - 2013					Forward - 2014				
	Unit	09-May	09-Apr	-1m	-3m	YTD	09-May	09-Apr	-1m	-3m	YTD
Key Commodities											
Coal API2	\$/ton	105.3	114.0	-7.7%	-8.7%	-10.7%	111.8	119.6	-6.6%	-6.9%	-8.4%
Coal API2	£/ton	65.4	71.7	-8.8%	-10.3%	-13.8%	69.4	75.3	-7.7%	-8.5%	-11.5%
Coal API4	\$/ton	104.8	111.6	-6.2%	-5.8%	-6.3%	108.6	115.5	-5.9%	-5.0%	-6.0%
Carbon	€/ton	7.1	7.2	-1.8%	-24.5%	-7.0%	7.5	7.8	-3.2%	-15.1%	-7.0%
TTF Gas	€/MWh	26.4	27.3	-3.0%	-2.1%	3.3%	26.3	27.2	-3.2%	-2.9%	2.4%
TTF Gas	\$/mmbtu	10.0	10.5	-4.2%	-4.4%	3.2%	10.0	10.4	-4.4%	-5.2%	2.3%
NBP Gas	p/therm	64.7	67.5	-4.1%	-1.6%	4.1%	64.9	67.5	-3.7%	-1.0%	1.2%
NBP Gas	\$/mmbtu	10.4	10.7	-2.9%	-2.0%	5.3%	10.4	10.7	-2.5%	-2.6%	4.8%
US Gas	\$/mmbtu	3.6	3.5	3.1%	-1.7%	-9.0%	4.0	4.0	0.1%	-2.2%	-8.6%
Brent Oil	\$/bbl	107.4	114.3	-6.1%	-2.6%	5.9%	101.5	107.1	-5.2%	-2.7%	4.4%
UK Prices											
Baseload Electricity	£/MWh	50.1	52.2	-4.0%	-4.5%	-1.2%	52.8	56.1	-5.8%	-5.1%	-2.6%
Clean Dark Spread	£/MWh	10.9	10.3	5.4%	33.0%	65.3%	6.8	7.3	-7.0%	6.8%	73.7%
Clean Spark Spread	£/MWh	0.7	0.8	-8.0%	42.9%	-60.1%	1.0	2.3	-56.9%	-35.0%	-62.9%
US Prices & Spreads											
PJM - Avg Prices	\$/MWh	39.4	39.8	-0.8%	na	na	41.6	42.6	-2.2%	-10.1%	na
PJM - Spark Spread	\$/MWh	14.1	15.7	-10.2%	-12.4%	-1.3%	13.4	15.2	-11.7%	-20.0%	-8.2%
MassHub - Avg Prices	\$/MWh	40.3	39.0	3.4%	1.8%	-3.8%	41.8	41.2	1.3%	-7.6%	-5.2%
MassHub - Spark Spread	\$/MWh	14.2	13.5	5.6%	13.6%	11.4%	12.9	12.5	3.5%	9.4%	5.0%
Ercot - Avg Prices	\$/MWh	36.8	37.3	-1.2%	4.3%	1.7%	40.9	41.3	-1.1%	1.0%	3.8%

Source: Bloomberg, BofA Merrill Lynch Global Research

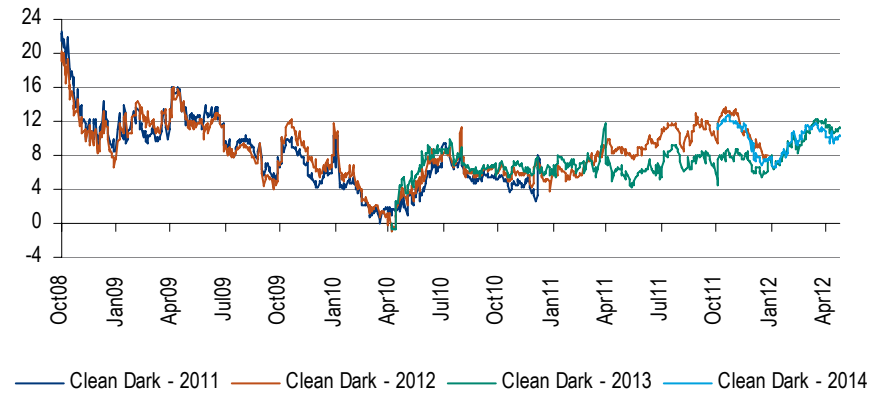
UK Power Prices

Chart 32: UK Baseload Forward Curve (£/MWh)



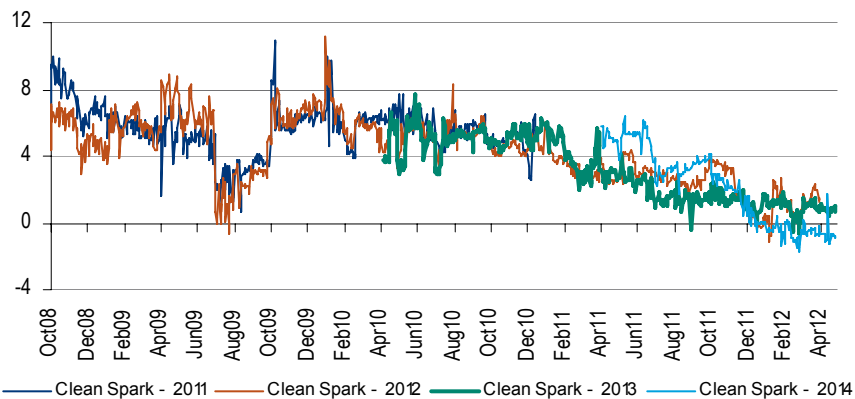
Source: Bloomberg, BofA Merrill Lynch Global Research

Chart 33: UK Baseload Generic Clean Dark Spreads (£/MWh)



Source: Bloomberg, BofA Merrill Lynch Global Research Note: 36% efficiency

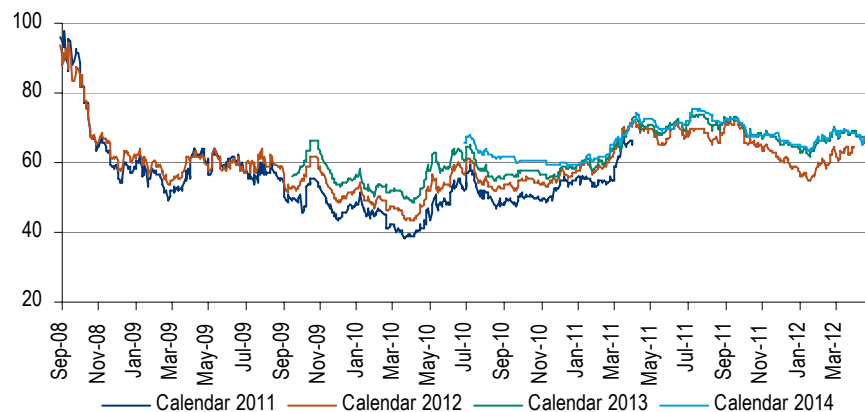
Chart 34: UK Baseload Generic Clean Spark Spreads (£/MWh)



Source: Bloomberg, BofA Merrill Lynch Global Research Note: 36% efficiency

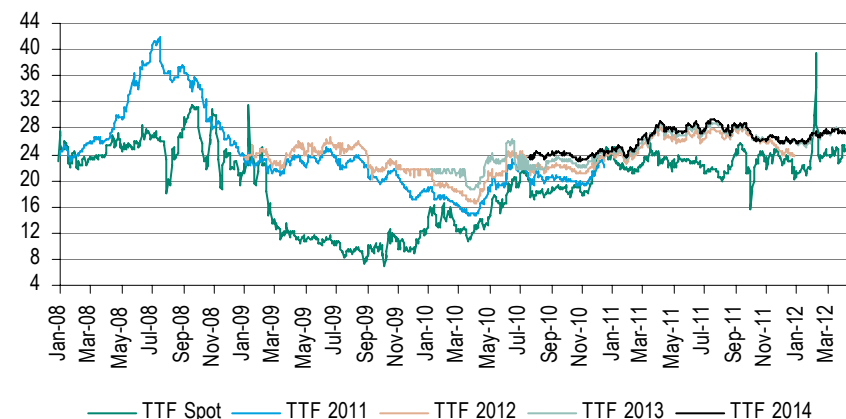
Natural Gas Prices

Chart 35: UK Natural Gas Baseload Forward Prices (GBP/therm)



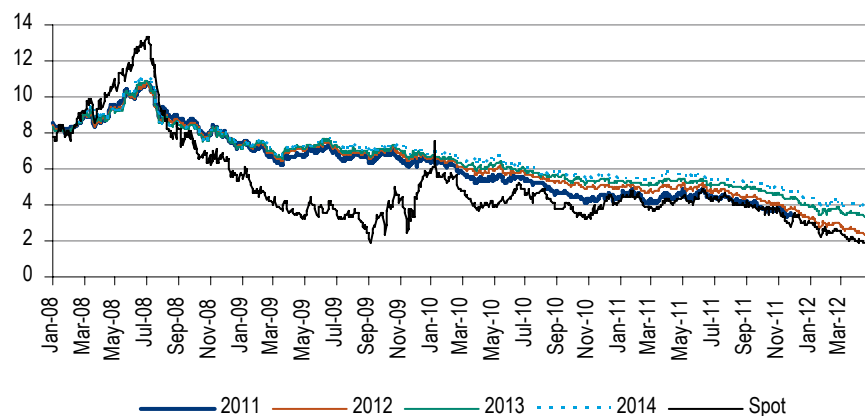
Source: Bloomberg, BofA Merrill Lynch Global Research

Chart 36: TTF Gas - (€/MWh)



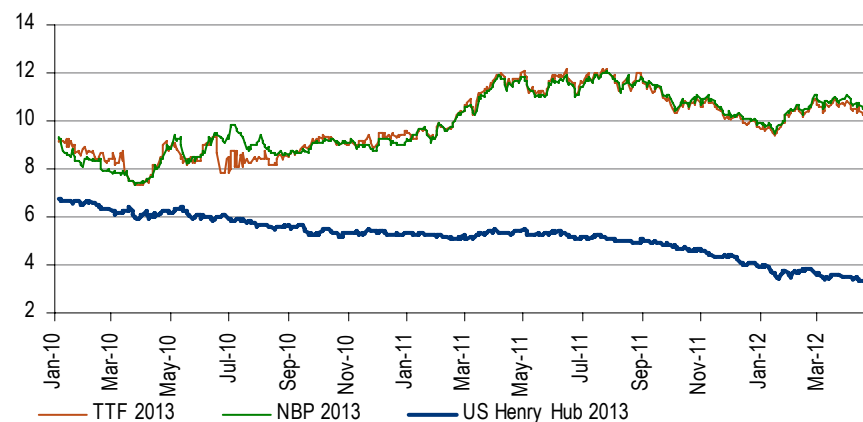
Source: Bloomberg, BofA Merrill Lynch Global Research

Chart 37: Henry Hub - Spot & Forward Prices (\$/mmbtu)



Source: Bloomberg, BofA Merrill Lynch Global Research

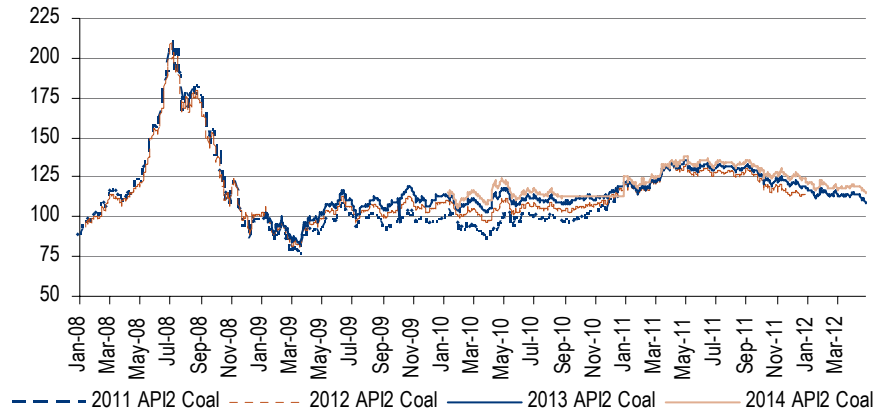
Chart 38: 2013 Global Gas Prices - Europe and US (\$/mmbtu)



Source: Bloomberg, BofA Merrill Lynch Global Research

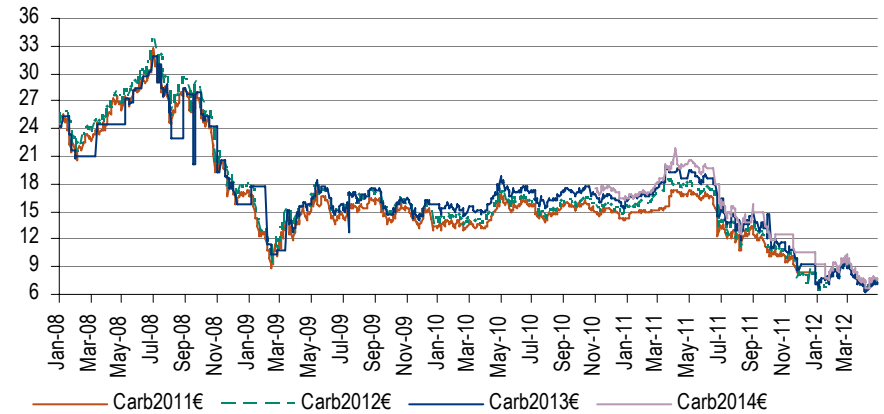
Coal, Carbon and Oil Prices

Chart 39: API2 Coal Prices (US\$/T)



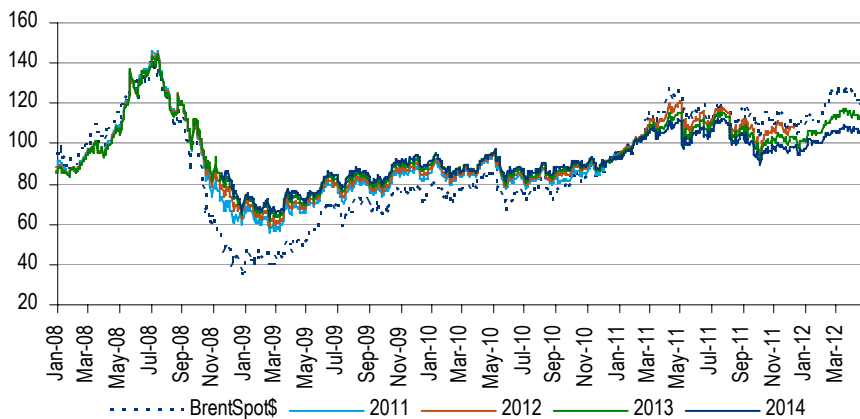
Source: Bloomberg, BofA Merrill Lynch Global Research

Chart 40: Carbon Prices (€/tons)



Source: Bloomberg, BofA Merrill Lynch Global Research

Chart 41: Brent Oil \$/bbl



Source: Bloomberg, BofA Merrill Lynch Global Research

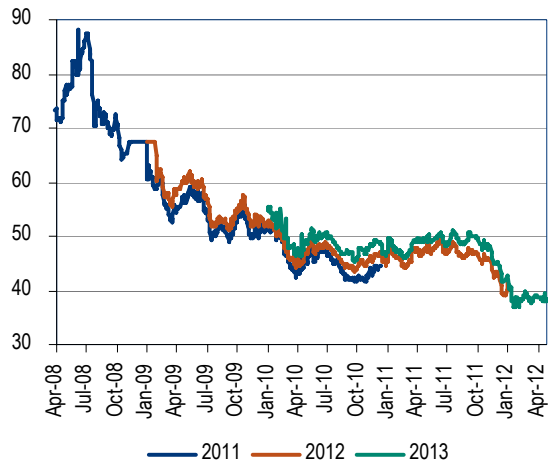
Chart 42: Baltic Dry Index



Source: Bloomberg, BofA Merrill Lynch Global Research

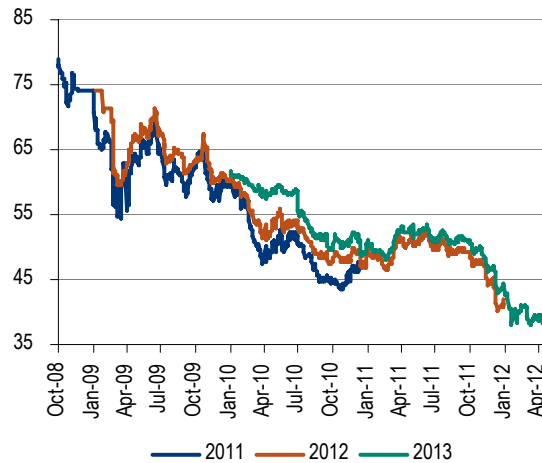
US Power Prices

Chart 43: PJM ATC Forward Prices (\$/MWH)



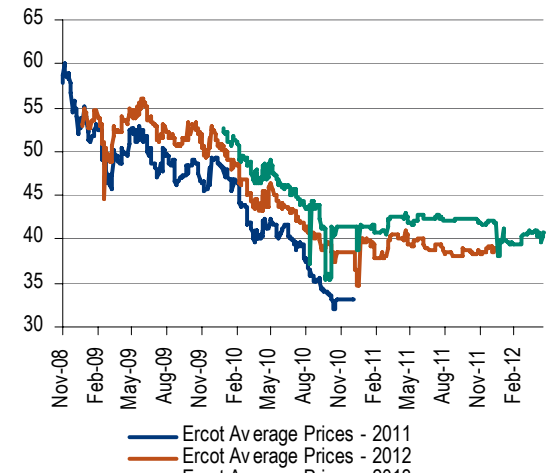
Source: Bloomberg, BofA Merrill Lynch Global Research

Chart 44: Mass Hub ATC Forward Prices (\$/MWH)



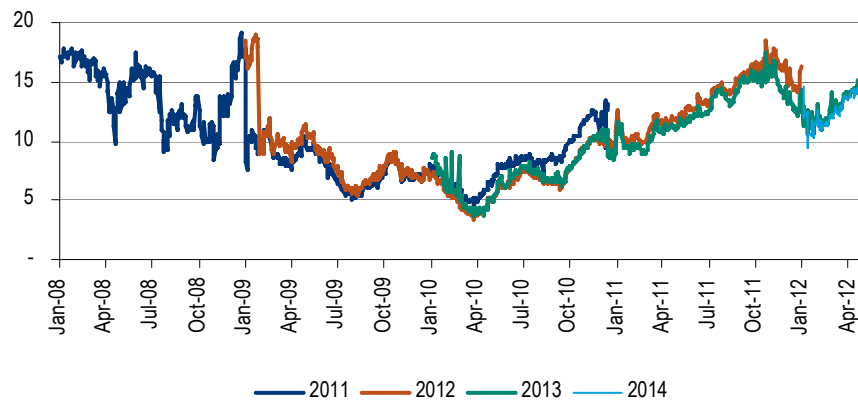
Source: Bloomberg, BofA Merrill Lynch Global Research

Chart 45: Ercot Average Forward Prices (\$/MWH)



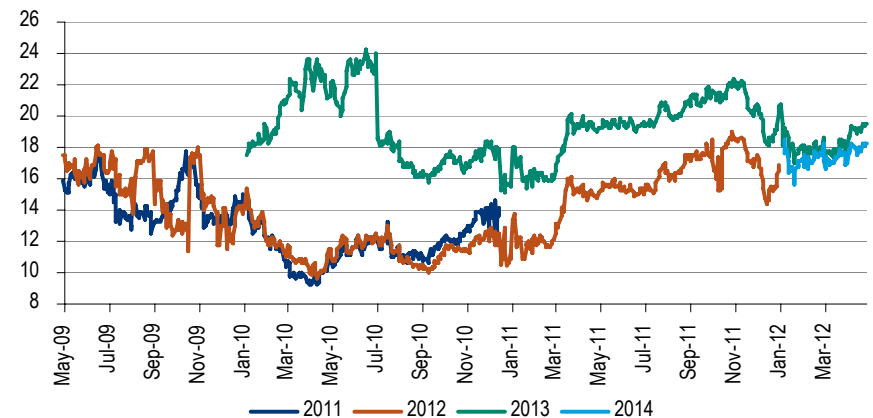
Source: Bloomberg, BofA Merrill Lynch Global Research

Chart 46: On Peak - PJM Spark Spread (\$/MWH)



Source: Bloomberg, BofA Merrill Lynch Global Research

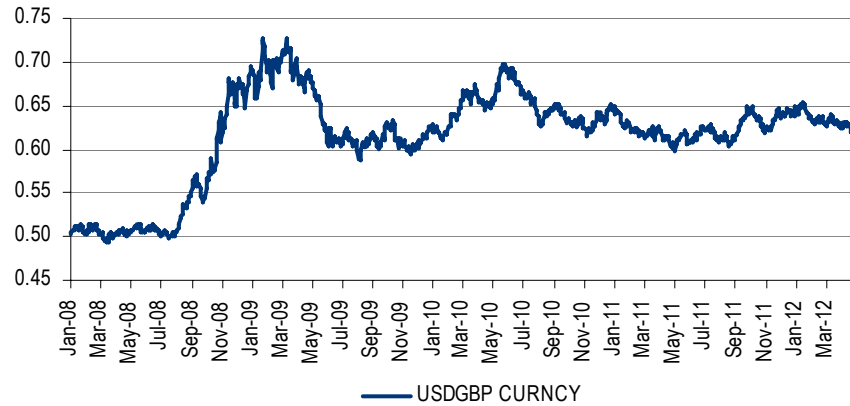
Chart 47: On Peak - Mass Hub Spark Spread (\$/MWH)



Source: Bloomberg, BofA Merrill Lynch Global Research

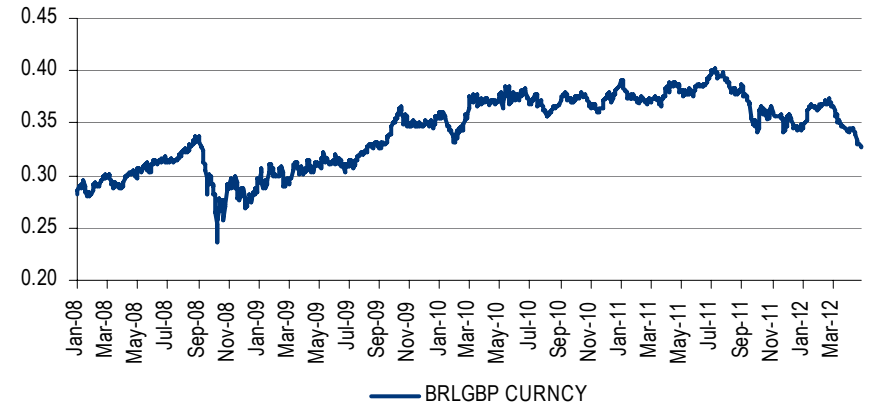
Foreign Exchange Charts

Chart 48: US Dollar vs British Pound



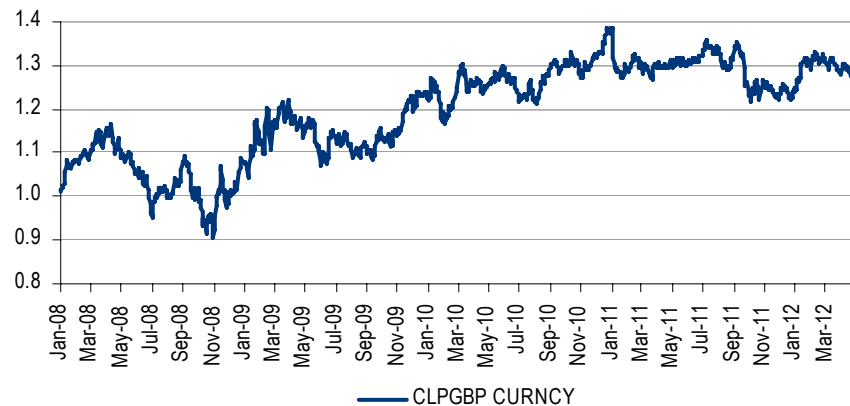
Source: Bloomberg, BofA Merrill Lynch Global Research

Chart 49: Brazilian Real vs. British Pound



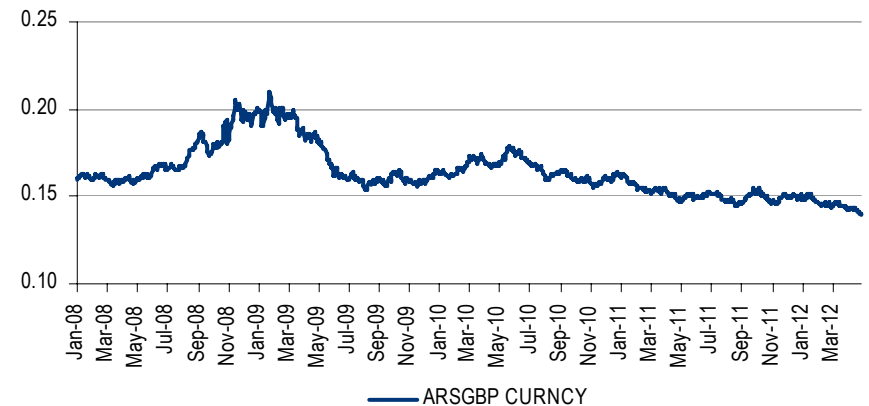
Source: Bloomberg, BofA Merrill Lynch Global Research

Chart 50: Chilean Peso vs British Pound



Source: Bloomberg, BofA Merrill Lynch Global Research

Chart 51: Argentine Peso vs. British Pound



Source: Bloomberg, BofA Merrill Lynch Global Research

UK Valuation Comps

Table 11: BofAML UK Utilities - Price Performance

As at COB	Tue 08 May 12								12 Month	MktCap	EV FY1	Share Price Performance		
Company	Sector	Ticker	Recommendation	FY1 Year		Price	PO	Return	GBP mn	GBP mn		-1w Abs	-3m Abs	-12m Abs
Centrica	UK	CPYYF	Underperform	A-3-7	Dec 2012	GBP 309	295.0	0.8%	16,071	20,230		0.2%	9.2%	7.5%
Scottish & Sthrn	UK	SSEZF	Neutral	A-2-7	Mar 2013	GBP 1,329	1,325	5.7%	12,459	20,988		1.6%	10.6%	11.5%
National Grid	UK	NGGTF	Neutral	A-2-7	Mar 2013	GBP 670	640	1.4%	29,688	55,617		1.6%	7.8%	19.5%
Drax Group Ltd	UK	DRXGF	Underperform	C-3-8	Dec 2012	GBP 557	400	-24%	2,524	2,222		2.3%	12.3%	37.2%
Regulated Water														
Penon	UK	PEGRF	Underperform	C-3-7	Mar 2013	GBP 735	700	-1.1%	3,333	6,272		0.3%	11.3%	23.1%
Severn Trent	UK	SVTRF	Buy	A-1-7	Mar 2013	GBP 1,655	1,690	6.4%	4,884	10,239		-0.4%	13.4%	21.8%
United Utilities	UK	UUGWF	Buy	A-1-7	Mar 2013	GBP 631	685	13.6%	5,342	12,167		1.8%	9.2%	10.6%

Source: BofA - Merrill Lynch Global Research

FY1 Dec year ending companies = 2011E, for March ending companies FY1 = 2011/12E

Table 12: BofAML UK Utilities - Multiples

As at COB	Tue 08 May 12				P/E				EPS		Gross Yield				DPS		Payout			
Company	Sector	Ticker	Price		FY1	FY2	FY3	FY4	4 Yr CAGR		FY1	FY2	FY3	FY4	4 Yr CAGR		FY1	FY2	FY3	FY4
Centrica	UK	CPYYF	GBP 309		11.4x	10.6x	10.4x	10.3x	3.9%	5.4%	5.8%	6.3%	6.8%	8.0%	61.1%	61.5%	65.5%	69.6%		
Scottish & Sthrn	UK	SSEZF	GBP 1,329		11.4x	10.9x	10.4x	9.1x	9.0%	6.3%	6.6%	7.0%	7.3%	5.0%	71.9%	72.5%	72.6%	66.2%		
National Grid	UK	NGGTF	GBP 670		12.2x	11.3x	11.0x		4.3%	6.1%	6.3%	6.6%		5.0%	74.1%	71.6%	72.2%			
Drax Group Ltd	UK	DRXGF	GBP 557		10.8x	19.4x	28.5x	30.0x	-24.1%	4.6%	2.6%	1.8%	1.7%	-24.1%	50.0%	50.0%	50.0%	50.0%		
Regulated Water																				
Penon	UK	PEGRF	GBP 735		16.2x	15.4x	13.7x	12.7x	8.1%	3.9%	4.1%	4.4%	4.7%	6.5%	62.8%	63.6%	60.0%	59.4%		
Severn Trent	UK	SVTRF	GBP 1,655		16.7x	16.7x	17.0x	16.0x	4.6%	4.6%	4.8%	5.1%	5.3%	5.9%	76.2%	80.7%	86.4%	85.4%		
United Utilities	UK	UUGWF	GBP 631		17.0x	16.6x	16.3x	16.0x	3.0%	5.4%	5.7%	5.9%	6.1%	4.7%	92.2%	94.6%	96.7%	97.4%		

Source: BofA - Merrill Lynch Global Research

FY1 Dec year ending companies = 2011E, for March ending companies FY1 = 2011/12E

Table 13: BofAML UK Utilities - Inputs

As at COB				Tue 08 May 12		EPS				EPS	DPS				DPS	EBITDA				EBITDA
Company	Sector	Ticker	Price		FY1	FY2	FY3	FY4	4 Yr CAGR	FY1	FY2	FY3	FY4	4 Yr CAGR	FY1	FY2	FY3	FY4	4 Yr CAGR	
Centrica	UK	CPYYF	GBP	309	27.21	29.22	29.62	30.09	3.9%	16.63	17.96	19.40	20.95	8.0%	3,815	4,251	4,169	4,126	7.2%	
Scottish & Sthrn	UK	SSEZF	GBP	1,329	116.89	121.62	127.63	146.80	9.0%	84.00	88.20	92.61	97.24	5.0%	2,322	2,437	2,550	2,735	6.5%	
National Grid	UK	NGGTF	GBP	670	55.13	59.38	61.16		4.3%	40.86	42.49	44.19		5.0%	5,145	5,532	5,874		7.7%	
Drax Group Ltd	UK	DRXGF	GBP	557	51.66	28.77	19.55	18.54	-24.1%	25.8	14.4	9.8	9.3	-24.1%	306	201	180	182	-14.1%	
Regulated Water																				
Pennon	UK	PEGRF	GBP	735	45.37	47.67	53.81	57.92	8.1%	28.5	30.3	32.3	34.4	6.5%	444	470	522	577	8.4%	
Severn Trent	UK	SVTRF	GBP	1,655	99.39	98.99	97.51	103.14	4.6%	75.7	79.9	84.3	88.1	5.9%	818	834	847	886	3.6%	
United Utilities	UK	UUGWF	GBP	631	37.20	37.91	38.78	39.48	3.0%	34.3	35.9	37.5	38.4	4.7%	919	953	992	1,026	3.5%	

Source: BofA Merrill Lynch Global Research

FY1 Dec year ending companies = 2011E, for March ending companies FY1 = 2011/12E

Table 14: BofAML UK Utilities - Cash Flow

As at COB																		
Company	Tue 08 May 12				EV/EBITDA				EBITDA 4 Yr CAGR	FCF Yield				Economic Net Debt / EBITDA				Net Debt Cap Em
	Sector	Ticker	Price		FY1	FY2	FY3	FY4		FY1	FY2	FY3	FY4	FY1	FY2	FY3	FY4	
Centrica	UK	CPYYF	GBP	309	5.3x	4.8x	4.9x	5.0x	7.2%	-3.4%	5.0%	4.6%	5.4%	1.6x	1.6x	1.4x	1.5x	34.7%
Scottish & Sthrn	UK	SSEZF	GBP	1,329	9.0x	8.8x	8.4x	7.7x	6.5%	2.9%	4.9%	6.8%	12.7%	2.8x	2.8x	2.8x	2.8x	47.9%
National Grid	UK	NGGTF	GBP	670	8.7x	8.5x	8.5x		7.7%	-2.3%	-3.9%	-5.3%		4.1x	4.1x	4.2x	4.4x	63.6%
Drax Group Ltd	UK	DRXGF	GBP	557	5.9x	11.7x	13.9x	13.7x	-14.1%	4.9%	-23.7%	-5.7%	2.6%	-0.5x	-0.7x	1.6x	1.6x	-17.6%
Regulated Water																		
Pennon	UK	PEGRF	GBP	735	11.4x	11.2x	10.5x	9.7x	8.4%	-2.0%	-3.7%	-3.5%	2.4%	5.3x	5.4x	5.6x	5.5x	69.9%
Severn Trent	UK	SVTRF	GBP	1,655	10.1x	10.1x	10.1x	9.7x	3.6%	2.2%	2.2%	2.4%	3.1%	5.5x	5.3x	5.3x	5.4x	73.5%
United Utilities	UK	UUGWF	GBP	631	10.7x	10.6x	10.5x	10.4x	3.5%	-7.8%	-7.2%	-6.8%	-5.4%	5.8x	6.0x	6.1x	6.2x	74.5%

Source: BofA - Merrill Lynch Global Research

FY1 Dec year ending companies = 2011E, for March ending companies FY1 = 2011/12E

Link to Definitions

Energy

Click [here](#) for definitions of commonly used terms.

Analyst Certification

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

Special Disclosures

BofA Merrill Lynch is currently acting as advisor to ConocoPhillips in connection with the disposal of its North Sea UK and Norwegian assets to Endeavour Energy UK Ltd (a subsidiary of Endeavour International Corp), which was announced on December 27, 2011.

BofA Merrill Lynch is also acting as advisor to ConocoPhillips on the disposal of its gas and oil producing Statfjord field to Centrica Plc, which was announced on January 30, 2012.

Price objective basis & risk

Centrica (CPYYF)

We have set a price objective of 295p/\$18.67, consistent with our sum of the parts valuation. Our SOP uses a range of valuation tools such as DCFs and multiples for the various divisions as appropriate. At our PO, the shares would trade on 2012E P/E of 11x, and yield 5.6%.

Downside risks to our price objective include political interventions in the energy supply markets, sustained competitive pressure and softer wholesale gas prices. Upside risks include higher wholesale gas/power prices (assuming pass through to consumers) and a faster than expected recovery at British Gas Services.

Drax Group Ltd (DRXGF)

Our price objective is 400p. We calculate a fair value for Drax using a life of plant DCF with a 9% discount rate - Drax is very sensitive to dark green spreads which are related to assumed commodity prices and can be volatile - this represents both a risk and an opportunity. Our central case valuation assumes generic dark green spreads expand further to peak at GBP12/MWh in 2012 and subsequently retreat to our long term assumption of cGBP6-8/MWh in real terms, mainly because of the impact of the UK's carbon floor. We also assume 1xROC for biomass cofiring and modification of the plant to allow 50% biomass burn by 2015. Upside risks to our price objective are rising gas prices, tighter UK generation supply and more favourable government decisions on biomass ROC banding or capacity payments (due H1 2012). The company's price-taker business model means it is very exposed to the price of gas, coal and carbon and adverse movements in these commodities is a downside risk.

National Grid (NGGTF)

Our price objective of 640p (US\$50.14/ADR) is based on a sum of parts analysis using various metrics appropriate to the groups many divisions including

regulated asset values, DCF, earnings and cash flow multiples. We include an average 16pc premium to UK regulatory asset values to capture RAV growth and outperformance potential (the RAV benchmark has been rolled forward to March 2013). For the US, we use 12x P/E and 1.2x rate base, a discount to the peer group's 14x P/E and 1.4x rate base. The most significant risks would be an adverse change in the regulatory or political environment, particularly in the USA, that results in lower than expected revenues or growth potential. Higher debt costs or difficulty accessing capital could also impact on actual returns and growth potential. Currency exposure to the US dollar is mitigated by dollar denominated debt and swaps. Upsides include better than expected outcomes from regulatory reviews and confirmation of medium term financing plans.

Pennon (PEGRF)

Our 700p price objective is based on a 8.5% EV/RAV premium to the water utility SWW's 2013 RAV and our valuation for the waste division, Viridor. The premium to RAV for SWW factors in nominal asset growth (SWW below peers) and outperformance potential (SWW better placed than peers, particularly in financing).

Around 60% of Group EV is represented by the water utility's RAV, with Viridor contributing the balance. This differentiates it from the other remaining trio of listed UK water groups. Trading at our PO, Pennon would offer a prospective yield of c4% and would imply an above average EV/EBITDA multiple.

The upside risk to our price objective lies in a resumption of corporate activity. Trading conditions and growth prospects at Viridor as well the UK economic and inflation outlook present both upside and downside risks.

Scottish & Sthrn (SSEZF)

Our price objective is 1325p (US\$21.33/ADR). At our PO, the shares would trade on a 6.3% prospective yield and undemanding 10.7x 2013P/E. Our valuation is based on medium term fundamentals and uses metrics appropriate to each division, including DCF analysis (discount rates 7-8.5%), multiples, and Regulatory Asset Values as defined by Ofgem. Downside risks to our price objective are a permanent deterioration of both generation and supply margins, inability to execute new business objectives, political intervention, and an adverse change in the UK regulatory environment. The most significant upside risk is a faster than expected recovery in UK generation spreads and power prices.

Severn Trent (SVTRF)

Our price objective of 1690p has been set at a c8.5% EV premium to Severn Trent Water's RAV based sum-of-the-parts March 2013E. The premium mainly reflects the value of nominal asset growth and scope for outperformance. The valuation methodology is in line with peers.

At our PO, the prospective yield would be c4.5% and EV/EBITDA would be c10x, close to peers.

Upside risk to our price objective lies in a resumption of corporate activity. Changes to RPI assumptions present both upside and downside risks to earnings, dividends, debt metrics and valuations. Economic and market conditions may have an impact on water demand, bad debts, debt costs and inflation, which present both upside and downside risks. Lastly, changes in the regulatory framework may impact earnings stability and valuations. Trading conditions at Severn Trent Services may also impact the company's earnings outlook.

United Utilities (UUGWF)

Our price objective is 685p, based on a 8.5% EV premium to March 2013E RAV. In line with the valuation methodology used for its listed UK water peers, UU's RAV premium is justified by its asset growth profile (higher than peers) and scope for outperformance (similar to peers).

At our PO, dividend yield will be c5%, slightly above peers and this reflects UU's higher payout ratio.

The upside risk to our price objective lies in a resumption of corporate activity. Downside risks are underdelivery on cost cutting and efficiency. Changes in RPI present both upside and downside risk to earnings and valuations as well as sentiment. Changes in credit market conditions could effect UU's ability to efficiently raise new debt and refinance. Lastly, changes in economic trends in the UK could have an effect on revenues and costs via water demand and bad debts.

EMEA - Utilities Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY				
	EDP	EDPFY	EDPFY US	Pablo Cuadrado
	EDP	ELCPF	EDP PL	Pablo Cuadrado
	Gas Natural	GASNF	GAS SM	Pablo Cuadrado
	Severn Trent	SVTRF	SVT LN	Pinaki Das
	Snam Rete Gas	SNMRF	SRG IM	Pablo Cuadrado
	Suez Environnement	SZEVF	SEV FP	Eric Lopez
	Terna	TERRF	TRN IM	Pablo Cuadrado
	United Utilities	UUGWF	UU/ LN	Pinaki Das
	Veolia Environnement	VEOEF	VIE FP	Eric Lopez
	Veolia Environnement	VE	VE US	Eric Lopez
NEUTRAL				
	CEZ	CZAVF	CEZ CP	Christopher Kuplent
	E.ON	ENAKF	EOAN GR	Christopher Kuplent
	E.ON	EONGY	EONGY US	Christopher Kuplent
	EDF	ECIFF	EDF FP	Eric Lopez
	Enagas	ENGGF	ENG SM	Pablo Cuadrado
	Endesa	ELEZF	ELE SM	Pablo Cuadrado
	Fortum	FOJCF	FUM1V FH	Christopher Kuplent
	GDF SUEZ	GDSZF	GSZ FP	Eric Lopez
	National Grid	NGGTF	NG/ LN	Fraser McLaren
	National Grid	NGG	NGG US	Fraser McLaren
	Scottish & Sthrn	SSEZF	SSE LN	Fraser McLaren
	Scottish & Sthrn	SSEZY	SSEZY US	Fraser McLaren
	Verbund	OEZVF	VER AV	Christopher Kuplent
UNDERPERFORM				
	Centrica	CPYYF	CNA LN	Fraser McLaren
	Centrica	CPYYY	CPYYY US	Fraser McLaren
	Drax Group Ltd	DRXGF	DRX LN	Fraser McLaren
	Enel	ESOCF	ENEL IM	Pablo Cuadrado
	Iberdrola	IBDSF	IBE SM	Pablo Cuadrado
	Pennon	PEGRF	PNN LN	Pinaki Das
	Red Electrica	RDEIF	REE SM	Pablo Cuadrado
	RWE	RWNFF	RWE GR	Christopher Kuplent
	RWE	RWEOY	RWEOY US	Christopher Kuplent
RSTR				
	Internat'l Power	IPR	IPRPY US	Fraser McLaren
	Internat'l Power	IPRWF	IPR LN	Fraser McLaren

10 May 2012

Important Disclosures

Investment Rating Distribution: Utilities Group (as of 01 Apr 2012)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	72	40.91%	Buy	48	76.19%
Neutral	47	26.70%	Neutral	35	81.40%
Sell	57	32.39%	Sell	38	74.51%

Investment Rating Distribution: Global Group (as of 01 Apr 2012)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1881	49.24%	Buy	1265	73.38%
Neutral	992	25.97%	Neutral	641	70.75%
Sell	947	24.79%	Sell	548	62.27%

* Companies in respect of which BofA Merrill Lynch or one of its affiliates has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where BofA Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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