German Utilities Hammered in Market Favoring Renewables: Energy

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By Tino Andresen

Aug. 12 (Bloomberg) -- Germany, Europe's biggest electricity market, is beating up its traditional utilities.

RWE AG and EON SE are getting hurt by falling power prices and a shrinking market share this year. They're set to report second-quarter earnings this week just as RBC Capital Markets said both may need to raise capital.

"Lower earnings for RWE and EON have knock-on implications for the balance sheet of both companies," John Musk, an analyst at RBC Capital in London, said last week. "The market has yet to factor in the longer-term earnings impact of German power prices," which have dropped about 27 percent in a year.

Across Europe and some of the U.S., utilities that a decade ago dominated markets now struggle to cope with lower prices exacerbated by subsidized renewables that don't pay fuel costs. The pain is most acute in Germany, which led the world installing solar farms and has the largest offshore wind plans. Clean energy also has preference over fossil fuels in European wholesale markets, a job killer at traditional utilities.

EON of Dusseldorf and Essen-based RWE are considering halting coal and gas plants with capacity exceeding 20,000 megawatts and can supply 21 cities the size of Cologne, risking some of the combined workforce of more than 10,000.

"A significant part of our business model is now facing new challenges," RWE Chief Financial Officer Bernhard Guenther said in an interview, without being specific about halts or jobs. "Whatever we do in terms of cost and capex-cutting won't fully compensate the profit loss we see in conventional power generation." A RWE spokeswoman said there was nothing to add.

Merkel Response

Chancellor Angela Merkel's government has said it wants to reform the country's clean-energy subsidy law after the Sept. 22 elections and also rework the design of the country's power market. The German renewable boom has caused "huge problems for the system," Merkel said June 12 in Berlin.

RWE shares slumped to a decade-low last week and EON did likewise last month, as analysts reduced earnings forecasts.

"We have never seen mothballing to this extent," Susanne Nies, head of energy policy and generation at the Eurelectric AISBL lobby group, said by phone from Brussels. Europe's power demand will be lower in 2020 than in 2010, and utilities have "massively overestimated demand for gas-fired power."

Musk said the two may have to tap investors for cash in the next few years, estimating that RWE may have a capital need of about 2.5 billion euros ($3.3 billion), and EON may require 4 billion euros to maintain its rating, in a note to investors.

EON Reporting

EON tomorrow is expected to report first-half adjusted earnings almost halved from a year earlier, according to analyst estimates compiled by Bloomberg, while RWE will report on the following day.

Both utilities were among the biggest decliners in Germany's benchmark DAX index today, with RWE falling as much as 1.9 percent to 20.91 euros and down 1.5 percent at 12:59 p.m. in Frankfurt trading. EON dropped as much as 1.8 percent to 12.03 euros and was down 1.4 percent at the time.

The retrenchment is mirrored in the U.S., where burgeoning rooftop solar panels eat into the market share of utilities from New York to Hawaii. In Japan, the government is opening the market, giving traditional suppliers such as Tokyo Electric Power Co. pressure from new rivals.

Germany's four largest power producers had only invested enough in clean energy to control 4.9 percent of renewable capacity by 2012, according to Bremen-based Trendresearch GmbH, and the country will increasingly rely on wind and solar to fill the gap left by the nuclear phaseout. The share of renewables in generation more than tripled to 22 percent in 2012 from 2000.

Shares Slump

"The adaptation of the conventional power-plant fleet is indispensable because renewables get preference on the grid," said Thomas Deser, a portfolio manager at Union Investment GmbH, which holds EON and RWE.

EON and RWE's cost-cutting strategies haven't stopped stock slides. Together have lost about 76 percent of the $200 billion combined market value they had in early 2008.

RWE has slumped 32 percent this year in German trading, the most among companies on Europe's STOXX 600 Utilities index. EON has lost 13 percent. Both are unlikely to recover any time soon, according to Commerzbank AG.

"We have intact, long-term downsize trends at EON and RWE," Petra Kerssenbrock, a technical analyst at Commerzbank, said by phone from Frankfurt.

Profit Forecast

At EON, adjusted profit may drop 40 percent this year, according to the average estimate of analysts surveyed by Bloomberg. “For newer power plants there is always a latent risk for writedowns,” Chief Financial Officer Marcus Schenck said in an interview in May. EON kept its unprofitable Irsching 4 and 5 gas-fired generators in Bavaria running only after a compensation deal with regulator Bundesnetzagentur and grid operator TenneT TSO GmbH signed in April.

RWE’s income has declined for the past three years and is forecast to fall again next year.

“It’s all about shutting power plants with a negative cash flow,” Patrick Hummel, an analyst at UBS AG, said by phone from Zurich. Unlike a decade ago when utilities reduced capacity to push up electricity on the market, the current halts “won’t work to drive the power price,” he said.

Independent Producers

Independent power producers such as Wpd AG, Juwi AG and S.A.G. Solarstrom AG invested earlier and more heavily in wind and solar power, cutting into the share supplied by RWE and EON.

German year-ahead power price dropped 27 percent over the past 12 months, according to broker data compiled by Bloomberg. The contract, a European benchmark, traded at 36.70 euros a megawatt-hour today.

While utilities across Europe have seen demand dwindle, those in Germany are also contending with a phase-out of nuclear energy. RWE and EON acknowledge the decision to close all reactors by 2022 forces them to abandon plants they had counted on to produce income for years.

Smaller competitor EnBW Energie Baden-Wuerttemberg AG said last month it will shut four plants in Marbach and Walheim following “a drastic fall in revenue.” The utility expects earnings from generation and trading to plunge as much 40 percent this year.

The shift from fossil fuels has also hurt other operators in the country. Vattenfall AB, a Swedish utility with coal and nuclear plants in Germany, announced plans July 23 to split off non-Nordic units after writing down $4.6 billion. It will have to cut investments and push through deeper cost cuts, it said, partly blaming the failure of nations to align policies.

“The idea of an integrated European energy market is in shambles,” Chairman Lars G. Nordstroem said last month. “Energy politics is becoming increasingly national. Everyone looks at their natural assets and their policies.”

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