

20/11/2012

THE ITALIAN GAS MARKET

A European and domestic perspective

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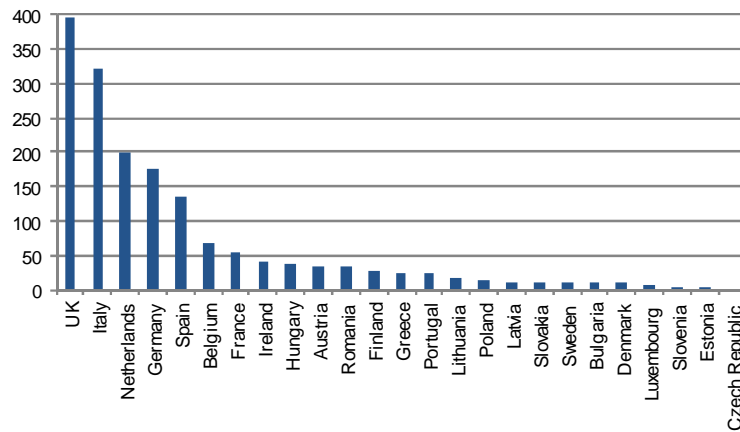
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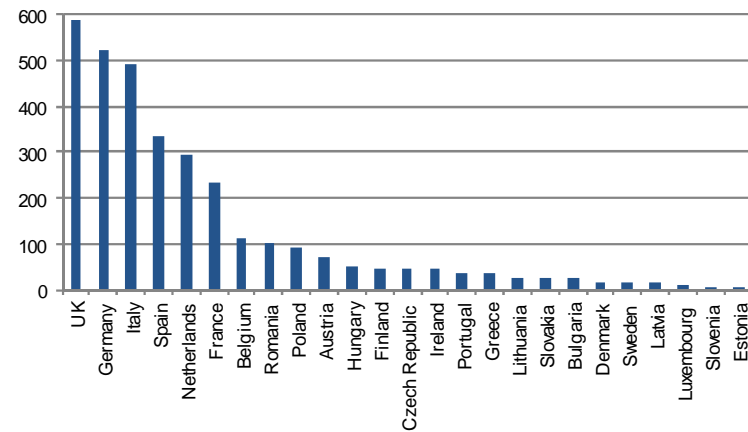
SOCIETE GENERALE
Cross Asset Research

ITALY'S RELIANCE ON GAS

Sales of natural gas in the EU27 (2010) to the power industry...



... and to power industry + industrial customers (TWh)



Source: SG Cross Asset Research, Eurogas 2011 Annual Report.

■ Italy's reliance on gas is high

- It is the second largest European gas market for power generation
- It is the third largest European gas market for power generation and industrial customers
- Gas and electricity (produced with gas) are an input to production processes, their high prices undermine Italy's competitiveness on international markets

■ Government's initiatives

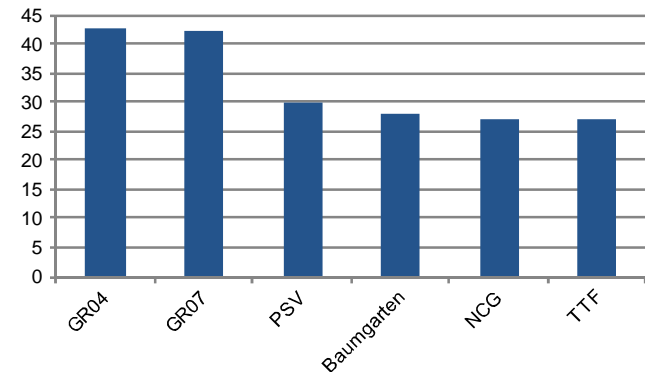
- The government aims at separating SNAM from ENI
- More investments in Italy and abroad are expected as a consequence
- The government wants Italy to become a gas-hub for Europe

WHICH GAS PRICE TO USE?

■ Long term gas contracts

- The majority of gas used in Italy is supplied via long term gas contracts
- Main supplies from Russia, Holland, North Africa. National production just c10% of consumption
- Some contracts renegotiated so far (Eg Edison=> Qatar, ENEL=>Nigeria)
- Gas Release price no longer representative of prices paid in the market

Gas forward prices, Cal13 (€/MWh)

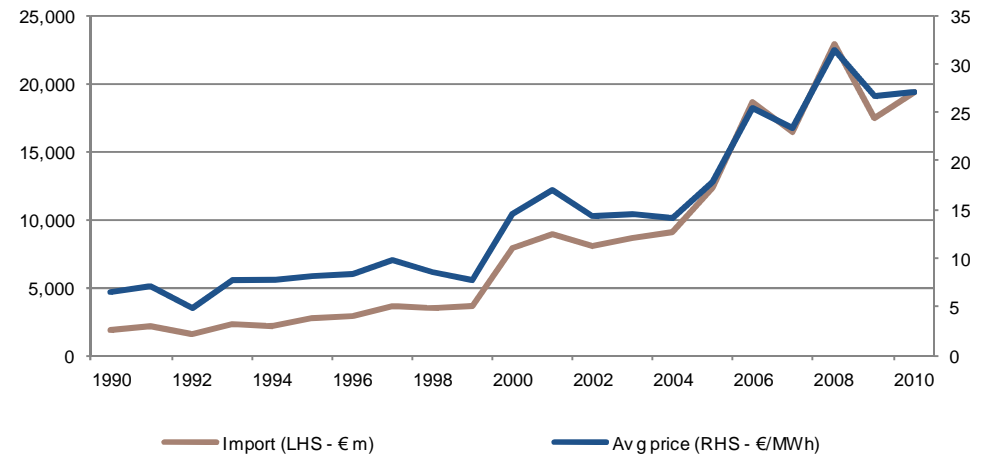


Source: SG Cross Asset Research, GeEO

■ Gas prices linked to oil

- Contracts still linked to oil
- Few have spot indexation
- ToP clauses typically 20-25% of nominal value of the contract
- Data from customs on import gas prices support the view that PSV is a more representative gas price to use

Italy – value of total gas imports (€m) and average price (€/MWh)



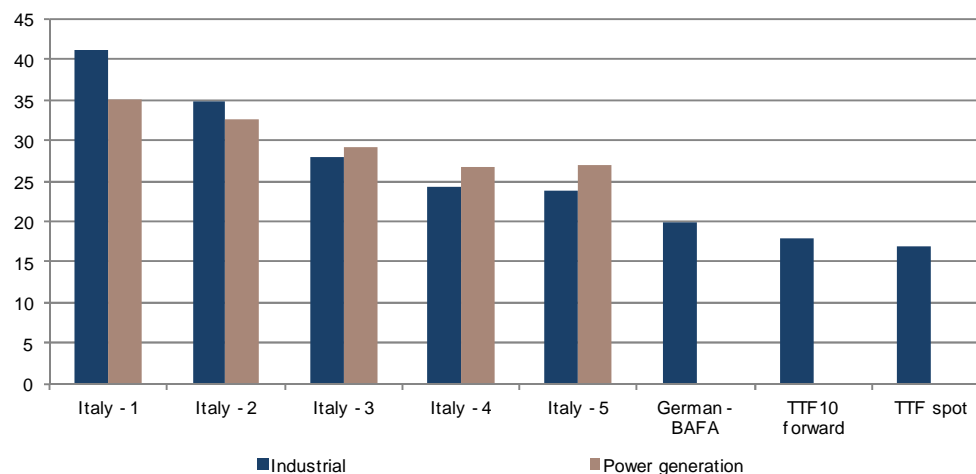
Source: SG Cross Asset Research; UP Statistiche Economiche November 2011

ITALY AT A PREMIUM

Historically trading at a premium

- Italian gas prices have been at a premium to rest of Europe for some time now
- Lack of competition on interconnection capacity is the main problem
- Recent AntiTrust decision forces ENI to release 5bcm of import capacity ('use it or lose it' principle)
- Italian import contracts are more expensive than in Germany...
- ... and so are spot prices

2010 gas prices – Italy* vs Germany** and TTF***

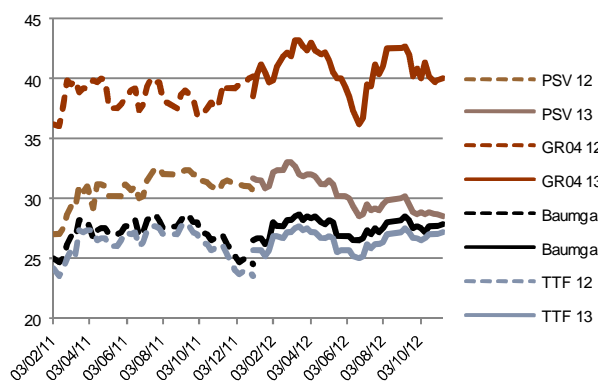


Source: SG Cross Asset Research; AEEG, Bloomberg, BAFA; (*) for Italy we show consumption clusters in m cu m per day: 1 <5k, 2 5k-<200k, 3 200k-<2m, 4 2m-<20m, 5 x>20m; (**) average of BAFA gas border prices for 2010; (***) spot TTF is the average of Day Ahead prices in 2010; 2010 forward TTF is the average in 2009 for the 2010 contract. From AEEG data we subtract €4/MWh in total to account for storage and transmission costs – in this way Italian prices are comparable to BAFA and TTF

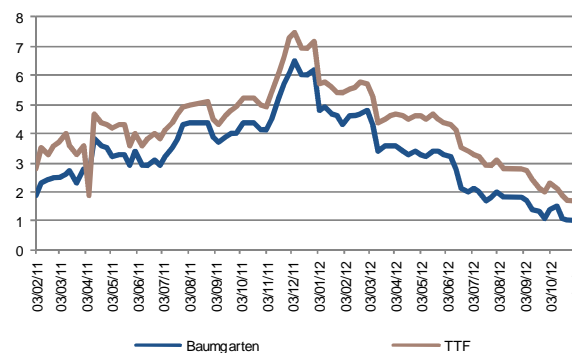
Lower spread now

- Spread now fallen from peak
- TTF gas prices moved up
- Italian gas prices down thanks to weaker oil...
- ...and lower demand

Forward gas prices (€/MWh)



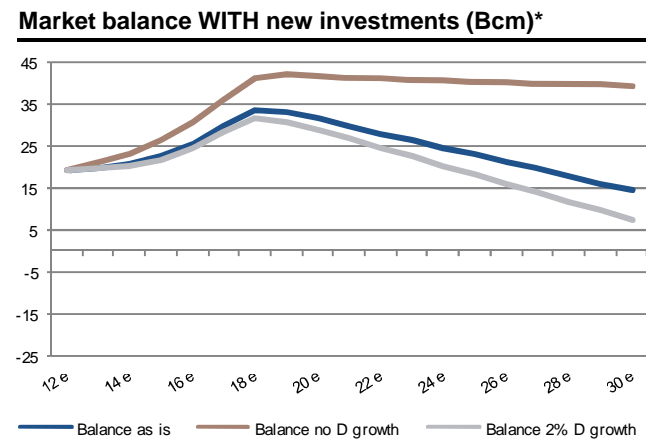
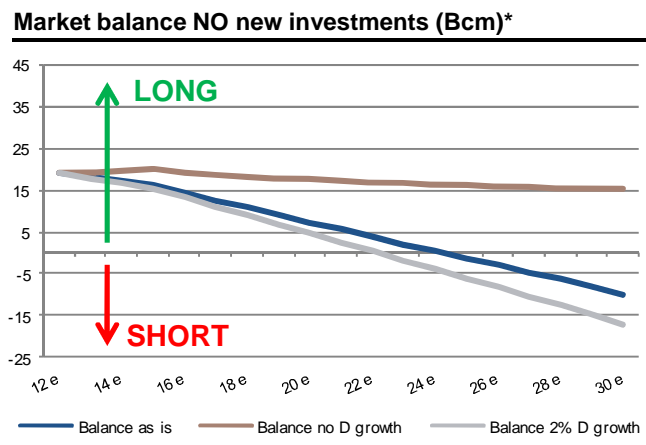
Spreads of forward gas prices (€/MWh)



THE FLIP SIDE OF LIBERALISATION

■ Slow recovery

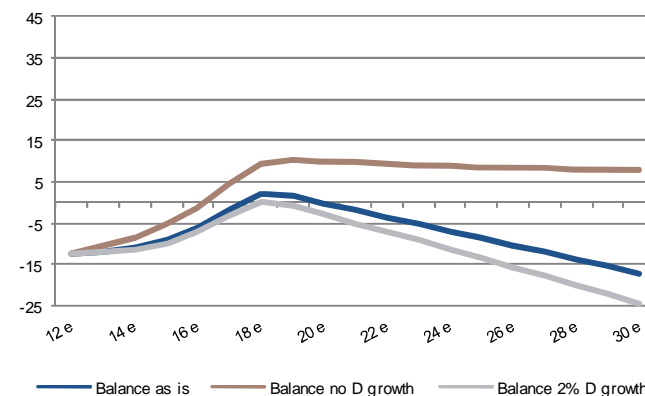
- Expected 100bcm by 2030 (ie 1.6% CAGR)
- Domestic production declining 10% p.a.
- LNG – Livorno + P.To Empedocle
- Pipelines – Galsi + IGI/TAP



■ Who wants to invest in a long market?

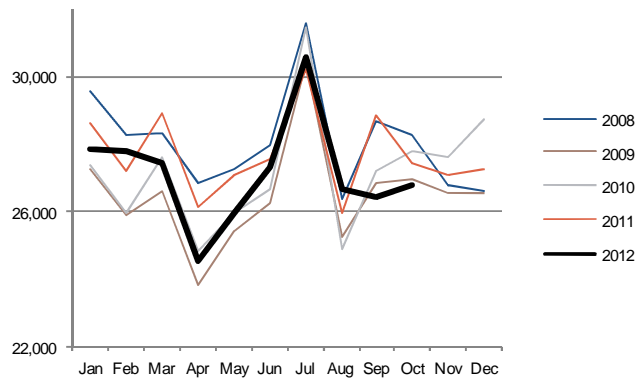
- Over-supply for a few years...
- ...keeps private money away
- Local opposition is a reality...
- ...and/or an excuse?
- Financing of new projects: merchant vs regulated terminals
- Where to source the gas from: contracted vs uncontracted terminals

Market balance (N-1)** and WITH new investments (Bcm)

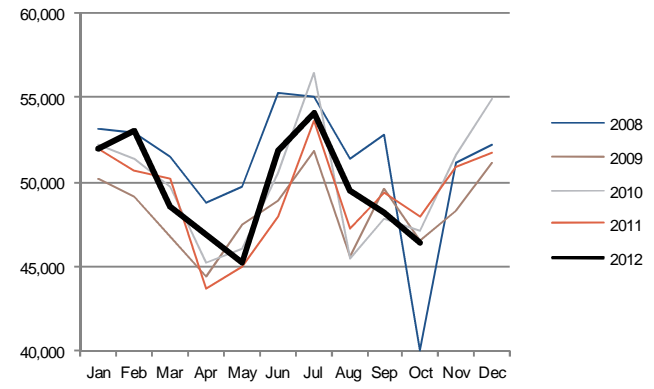


DEMAND DOWN, CAPACITY UP

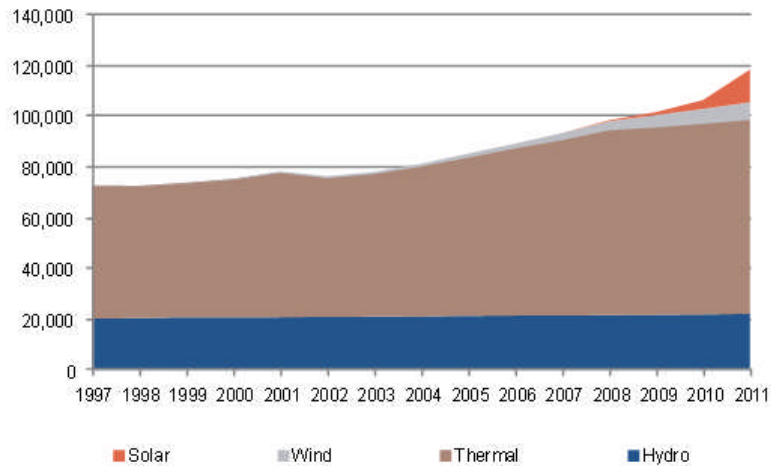
Demand of electricity – monthly (MWh)



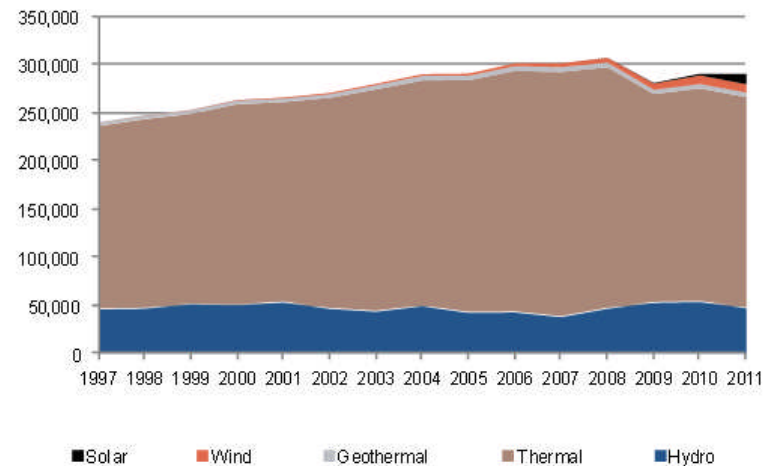
Peak demand – monthly (MW)



Installed capacity in Italy (MW)...



... and production (GWh) 1997-2011a



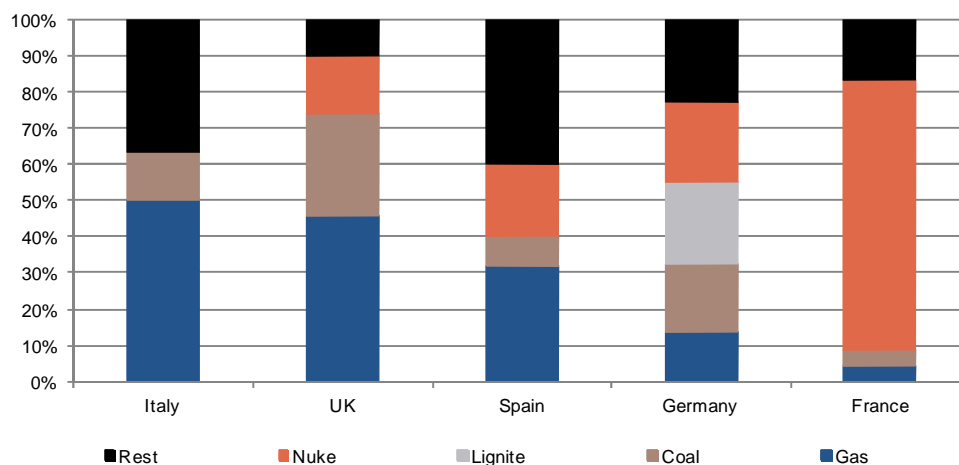
Source: SG Cross Asset Research, Terna

THE GAS BIAS

■ Gas in generation

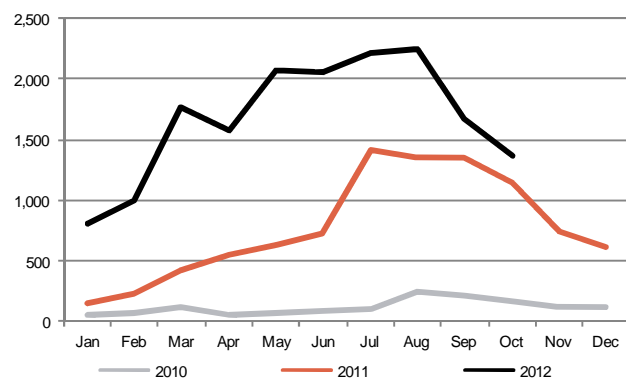
- Italy has no nuclear capacity
- Little coal and no lignite compared to other countries
- Gas is the most expensive fuel to burn, hence the impact on power prices
- Solar is now bigger than wind

Breakdown of generation volumes by technology (conventional generation 2010a)



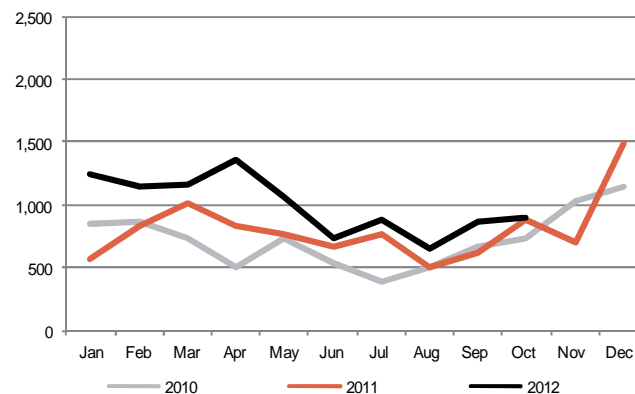
Source: SG Cross Asset Research, Bloomberg.

Photovoltaic production (GWh)



Source: SG Cross Asset Research, Terna

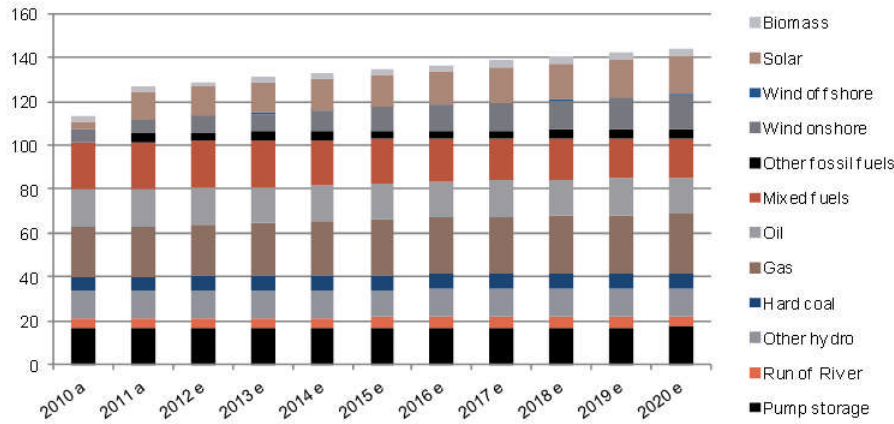
Wind production (GWh)



Source: SG Cross Asset Research, Terna

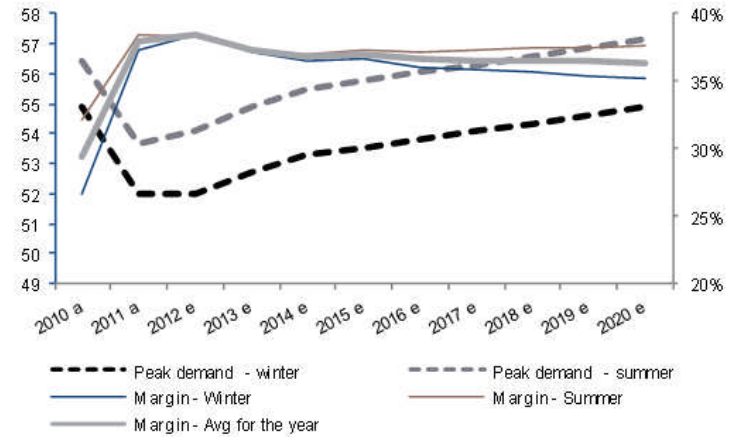
OVERSUPPLY IS HERE TO STAY

Installed capacity (GW) – growth from renewables only



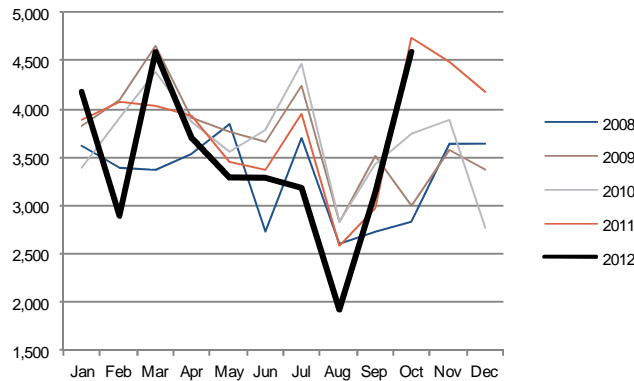
Source: SG Cross Asset Research, ENTSO-E, Terna

Reserve margin (RHS) and peak demand (LHS)



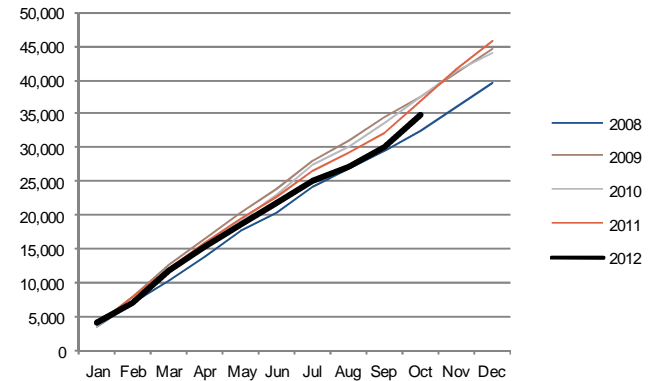
Source: SG Cross Asset Research, Terna

Net imports, monthly (GWh)



Source: SG Cross Asset Research, Terna

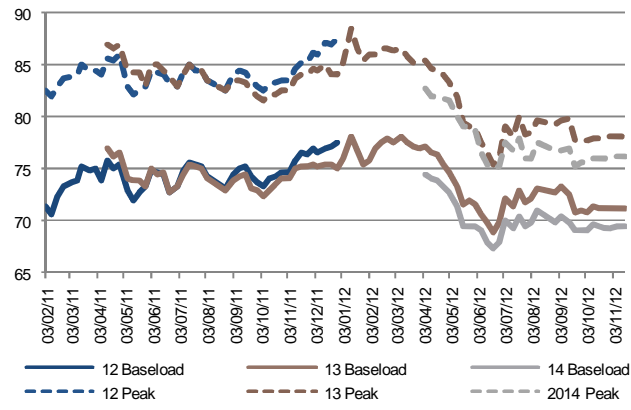
Net imports, cumulative (GWh)



Source: SG Cross Asset Research, Terna

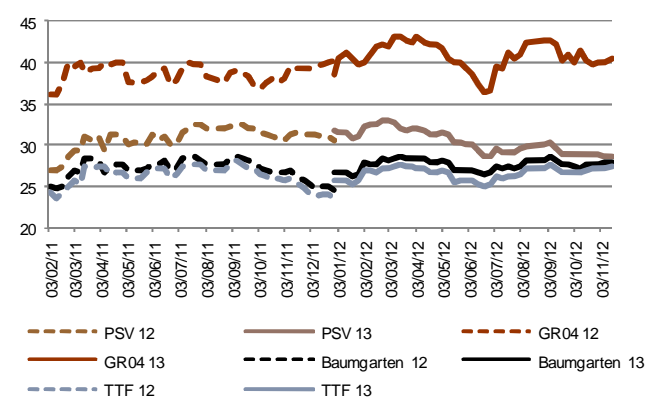
PRESSURE ON PRICES AND SPREADS

Power prices (€/MWh)



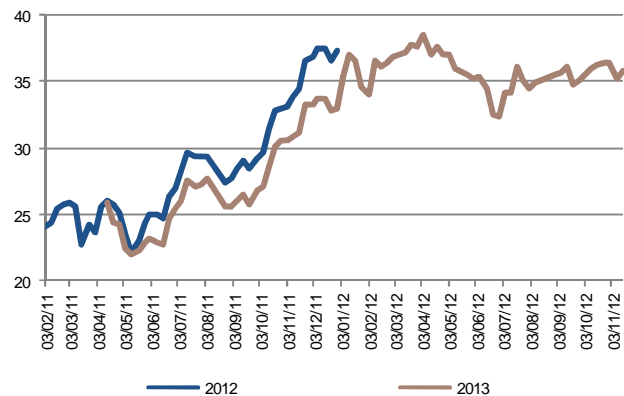
Source: SG Cross Asset Research, GeEO

Gas prices (€/MWh)



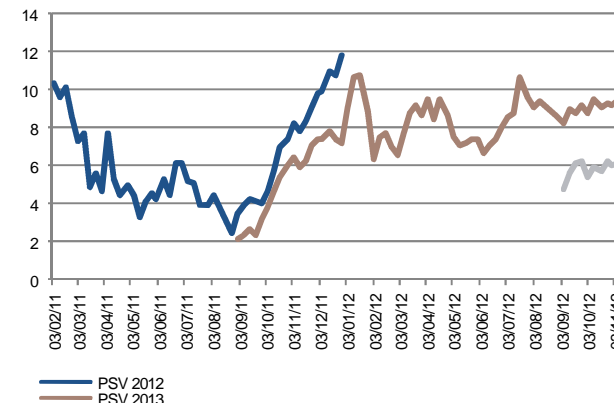
Source: SG Cross Asset Research, GeEO

Clean dark spread (€/MWh)



Source: SG Cross Asset Research, GeEO

Clean spark spread (€/MWh)



Source: SG Cross Asset Research, GeEO

THE 'GREAT OPPORTUNITY' IS ALSO A RISK

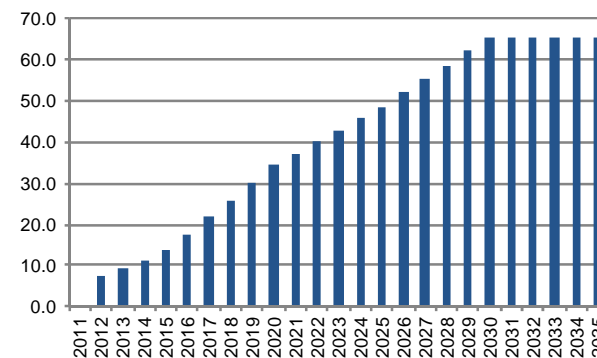
■ The opportunity

- Half of long term import gas contracts expire by 2020, all of them by 2030
- Recent renegotiations fuel hopes of lower prices going forward

■ The risk

- When contracts are renewed existing suppliers have no obligation to offer a lower price
- Italian importers have NO real alternative to existing pipes => have no negotiating power
- Gas prices may go UP not down as most expect

Schedule of expiring long-term gas contracts (bcm)



Source: SG Cross Asset Research

■ Competition of contracts

- More LNG is needed for existing suppliers to 'feel' a real threat
- LNG regulation could prompt the construction of at least 4/5 terminal
- SNAM could have a leading role along with other infrastructure players

New LNG projects

| LNG | City | Status | bcm | Owner |
|-----------------------|---------------------|----------|-----------|---------------------------------------------------------------------------|
| Zaule | Trieste | Approved | 8 | 100% Gas Natural |
| Brindisi | Brindisi | Approved | 8 | 100% BG |
| Gioia Tauro | Reggio Calabria | Approved | 12 | 25.5% Iride, Sorigenia 25.5%, 49% Belleli |
| Porto Empedocle | Agrigento | Approved | 8 | 90% Nuove Energie (ENEL) |
| Priolo Gargallo | | Approved | 8 | 50% ERG, 50% Shell |
| Livorno | | Approved | 4 | 46.79% EON, 2.69% OLT Energy Toscana, 3.73% Golar, 5.08% ASA 41.71%, IREN |
| <u>Total Approved</u> | | | <u>48</u> | |
| Monfalcone | Grado | Planned | 8 | Endesa |
| Ravenna (offshore) | Ravenna | Planned | 8 | Atlas LNG, ENI |
| Porto Recanati | | Planned | 5 | |
| Taranto | Taranto | Planned | 8 | 100% Gas Natural |
| Rosignano | Rosignano Marittimo | Planned | 8 | Edison, BP and Solvay |
| Panigaglia | | Planned | 4 | 100% Snam |
| <u>Total Planned</u> | | | <u>41</u> | |
| Grand total | | | 89 | |

Source: SG Cross Asset Research

MOVING FORWARD

■ Demand of gas is down but not out!

- Negative impact from recession, factories closing down, more renewables coming on line
- But don't write the epitaph just yet
 - ❖ Lower imports – at some point France could have problems, Germany as well during peak times
 - ❖ 150Bcm disappearing from European production will have to be imported

■ Diversification, we are far from there

- New pipes are from countries with identical/similar political risks
- Policy makers and the 'option value'

■ Surprise! The gas-cartel

- Higher indexation and/or shorter duration of l/t contracts
 - ❖ Gives market power to (the few) producers
 - ❖ Oil indexation means those who control the volumes don't control the price
 - ❖ Tomorrow those who control volumes will control prices

■ Delta price low now but could reverse

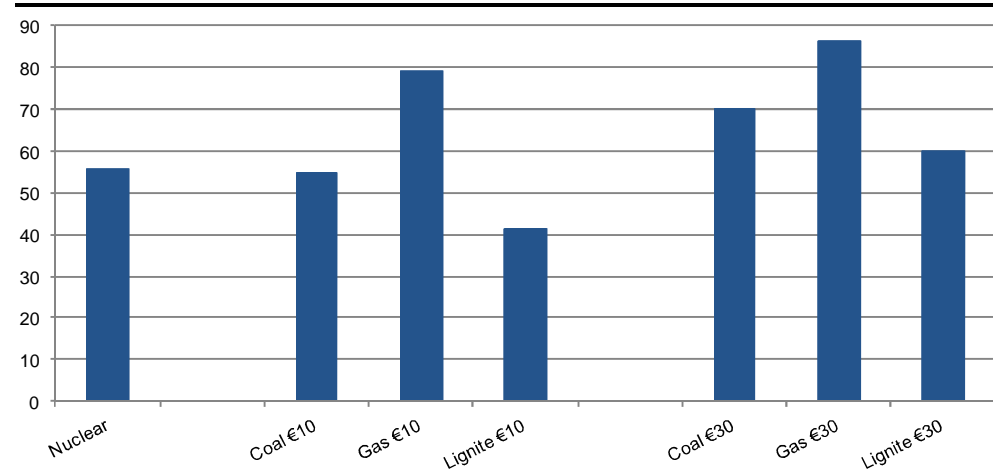
- TTF edging lower
- Gap with the rest of Europe could re-open, Italy remains exposed while excess supply disappears

■ The need for new infrastructures is still very much an issue

- LNG vs pipes => preference for LNG
- More storage needed
- Reverse flow

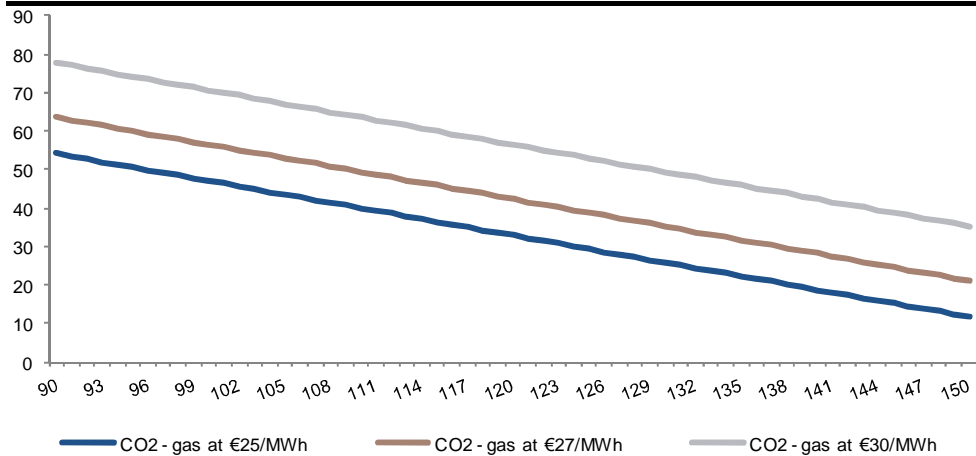
NEW ENTRANT COST

New Entrant cost (€/MWh)



Source: Société Générale Cross Asset Management, Bloomberg

CO2 price (Y-axis, €/t) as a function of Coal price (US\$/t) given the price of gas (€/MWh)



Source: Société Générale Cross Asset Management, Bloomberg

APPENDIX

COMPANIES MENTIONED

A2A Spa (A2.MI, No Reco)
 BBVA (BBVA.MC, Sell)
 Centrica (CNA.L, Buy)
 Drax (DRX.L, Sell)
 E.ON (EONGn.DE, Buy)
 EDF (EDF.PA, Buy)
 Edison (EDN.MI, No Reco)
 Endesa SA (ELE.MC, Hold)
 Enel (ENEL.MI, Buy)

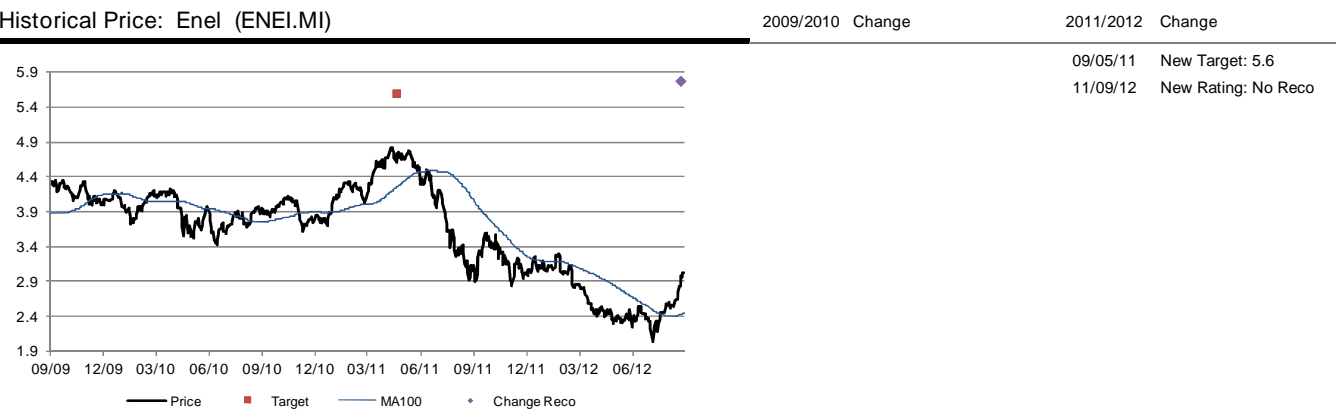
Energias de Portugal (EDP.LS, Hold)
 ENI (ENI.MI, Buy)
 Fluxys (DIST.BR, Sell)
 Fortum (FUM1V.HE, No Reco)
 Gas Natural SDG (GAS.MC, Buy)
 GDF Suez (GSZ.PA, Buy)
 Iberdrola (IBE.MC, Buy)
 IREN (IREE.MI, No Reco)
 Red Electrica (REE.MC, Buy)

RWE (RWE.G.DE, Hold)
 Saras (SRS.MI, Hold)
 Snam Rete Gas (SRG.MI, Buy)
 SSE (SSE.L, Sell)
 Suez Environnement (SEVI.PA, Buy)
 Tema (TRN.MI, Buy)
 Veolia Environnement (VIE.PA, Hold)

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Historical Price: Enel (ENEL.MI)



Source: SG Cross Asset Research

APPENDIX

SG EQUITY RESEARCH RATINGS (in effect through March 13, 2012)

BUY: expected upside of 10% or more over a 12 month period.

HOLD: expected return between -10% and +10% over a 12 month period.

SELL: expected downside of -10% or worse over a 12 month period.

Sector Weighting Definition:

The sector weightings are assigned by the SG Equity Research Strategist and are distinct and separate from SG research analyst ratings. They are based on the relevant MSCI.

OVERWEIGHT: sector expected to outperform the relevant broad market benchmark over the next 12 months.

NEUTRAL: sector expected to perform in-line with the relevant broad market benchmark over the next 12 months.

UNDERWEIGHT: sector expected to underperform the relevant broad market benchmark over the next 12 months.

Ratings and/or price targets are determined by the ranges described above at the time of the initiation of coverage or a change in rating or price target (subject to limited management discretion). At other times, the price targets may fall outside of these ranges because of market price movements and/or other short term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by research management.

APPENDIX

SG EQUITY RESEARCH RATINGS on a 12 months period (in effect as of March 14, 2012)

BUY: absolute total shareholder return forecast of 15% or more over a 12 month period.

HOLD: absolute total shareholder return forecast between 0% and +15% over a 12 month period.

SELL: absolute total shareholder return forecast below 0% over a 12 month period.

Total shareholder return means forecast share price appreciation plus all forecast cash dividend income, including income from special dividends, paid during the 12 month period. Ratings are determined by the ranges described above at the time of the initiation of coverage or a change in rating (subject to limited management discretion). At other times, ratings may fall outside of these ranges because of market price movements and/or other short term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by research management.

Sector Weighting Definition on a 12 months period:

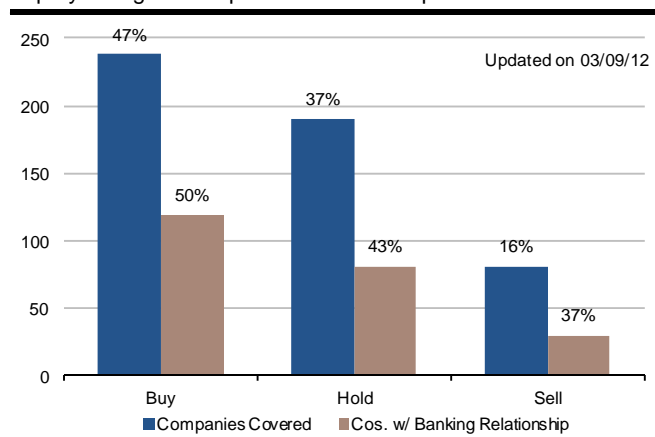
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Equity rating and dispersion relationship



Source: SG Cross Asset Research

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| BBVA | SG acted as joint lead manager in the BBVA's bond issue. |
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| EDF | SG acted as joint bookrunner in EDF's bond issue (15yr). |
| EDF | SG acted as joint bookrunner of EDF's senior bond issue (3.875% 18/01/22 EUR). |
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| EDF | SG acted as co-sponsor of EDF EN's squeeze out. |
| Enel | SG makes a market in Enel warrants |
| ENI | SG acted as joint bookrunner in ENI SPA's bond issue. (maturity 27/06/2019) |
| ENI | SG makes a market in Eni warrants |
| Gas Natural SDG | SG acted as joint bookrunner in Gas Natural's bond issue (6yr). |
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| Snam Rete Gas | SG is acting as joint bookrunner in SNAM's bond issue (5.5yr & 10yr). |
| Snam Rete Gas | SG acted as joint bookrunner in SNAM's bond issue (5% 18/01/19 EUR). |
| Veolia Environnement | SG acted as Structuring Advisor and Coordinator for Veolia Environnement's tender offer (FR0000474975; FR0010750497; FR0010397927; FR0000474983) and joint bookrunner in the new bond issue (4.625% 30/03/27 EUR). |

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