

Rising energy prices will fuel further consolidation in European energy markets over next 12 months

Paris, October 26th 2005 - The recent acceleration of merger and acquisition activity in European energy markets will continue over the next year as energy prices stay high and companies seek to compensate for their national market share decreases. This is the key finding from the latest edition of Capgemini's European Energy Markets Observatory¹, which warns that M&A activity will result in fewer energy companies in Europe and therefore less choice for businesses and consumers.

This year's Observatory contains a detailed financial analysis by Capgemini and Société Générale Equity Research of the 11 leading power companies in Europe. It finds that companies are in good financial shape and in a strong position to continue merger and acquisition activity.

Colette Lewiner, energy, utilities and chemicals global sector leader at Capgemini, said: "Larger players such as E.ON and RWE are reaping the benefits of major productivity improvement programmes and have the war chests they need to make further acquisitions. Overall in the industry, profitability in the sector has also improved as a result of growth in demand and increased wholesale and retail prices".

The Observatory also finds that security of supply is becoming more at risk across Europe. There has been a decrease in the level of operational generation surplus, and only limited progress in 2004 on building interconnections and other infrastructure investments.. Importantly, there is also clear evidence that companies have reduced their capital investments – the ratio of investment to turnover has been cut from 10.3% in 1998 to less than 5.5% in 2004; while the ratio of maintenance costs to turnover dropping from 10 % to 7% in the same timeframe.

Philippe David, Capgemini Program Director added: "In this year's Observatory we have analysed the consequences of severe weather conditions, such as the cold spell in Europe in early 2005, and the lack of hydropower in Spain. Security of supply is under threat during extreme weather conditions, which could lead to blackouts. More specifically, a shortage of rainfall can significantly impact the energy supply and demand balance, and thus push wholesale energy prices to high and non sustainable levels"

Some short-term solutions exist, adds Lewiner. Over the next two years, the industry must:

- Bring new capacity already under construction on-stream
- Provide incentives to customers to reduce demand in peak periods
- Improve short-term mechanisms to supply power from one zone to another
- Increase European electricity interconnection capacity
- Invest in new Distribution networks and improve the maintenance levels.

The Observatory also identifies longer-term solutions, which are recognised by the EC European directive on security of supply. In addition to demand-side management there should be an increased focus on the re-introduction of nuclear programmes in a number of European countries or possible revision to the phase-out nuclear policy in some others. Finland and France have already started to invest in the next generation nuclear European Pressurised Reactor power plants (EPR).

Other key findings detailed in the Capgemini's European Energy Markets Observatory include:

- CO₂ Emission rights are being traded on specific spot markets and rose sharply from 5€/ton of carbon to around 20€/ton in mid-2005 – these unexpectedly high prices will impact positively or negatively the operator's bottom line, depending on their generation mix and Emission Allowances.
- Oil and Gas price increases have impacted the wholesale electricity prices, which increased by 13 to 20% from winter 2003-04 to winter 2004-05 (13% increase of average weighted prices on German Power exchange EEX, 21% increase on French Power exchange Powernext). However, these wholesale price increases have in general not been passed to residential customers yet.
- The UK has moved from being the third cheapest in Europe to the third most expensive amongst the 10 countries where customers are eligible to switch vendors

Lewiner concludes: "Competition or, in some countries the presence of regulated tariffs, has kept suppliers from passing wholesale price increases on to customers. This report shows that contrary to the simple economic theories of deregulation, the July 2004 retail market opening milestone did not result in retail price decreases and has not yet triggered significant client switches. This again emphasizes that electricity and gas markets are different from other commodity markets, being heavily influenced by long term planning and investment requirements, as well as political factors.

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