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European Utilities: Trump 2.0 – A Curse or Blessing in Disguise?

Key Takeaways

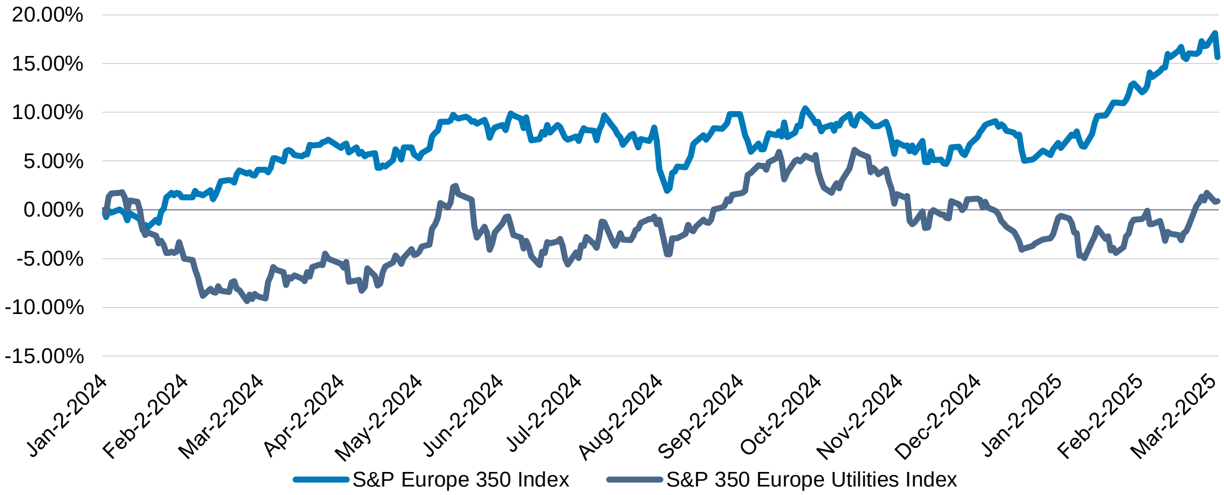
Positive (+) or Negative (-) Implications
(+) Enel SpA (ENEL IM)
(+) Iberdrola S.A. (IBE SM)

- As President Trump took over presidency in the U.S. once again in January 2025, it marks an unsettling uncertainty over global markets. While the Trump administration has hinted at imposing new tariffs on European goods and the president's preference for natural gas, which could lead to retaliation from the European Union (EU), we think it is unlikely to stop Europe's commitment to renewable investments.
- While we expect interest rates to trend lower in 2025, we believe they will remain at elevated levels compared to historical levels. On this front, we see valuation recovery for European utilities in 2025. However, potential Trump administration policies, such as tariffs and fiscal expansion, could slow down rate cuts due to higher inflation. Also, we do not expect a huge beat in European utilities' valuation compared to other sectors and remain selective with high-quality European utility companies, which we think will provide healthy cash flow and shareholders' remuneration.
- Based on our analysis, **Iberdrola** and **Enel** remain our top picks in 2025 for European utilities under our coverage due to their quality cash flows and dividend yields.

Fundamental Context

European utilities remained one of the most underperforming sectors in 2024. The S&P Europe 350 Utilities Index recorded a poor 3.5% decline in 2024, underperforming the broader market, the S&P Europe 350 index, which grew 6.1% during the same period (Figure 1). Most of the defensive sectors in European markets, such as utilities and consumer staples, experienced notable underperformance in 2024, which we believe is due to a relatively high interest rate environment. Hence, European utilities with high leverage could be heavily affected by an impaired ability to maintain similarly high shareholders' remuneration, which has proved to be the key selling point for utility companies. Therefore, we remain highly selective with European utilities with healthy cash flows to maintain high shareholders' remuneration. Also, our sector positioning remains tilted toward defensive in Europe in 2025, as we think defensive stocks will outperform as we project European interest rates to trend lower in 2025. Given an elevated interest rate level despite anticipated rate cuts, we see potential valuation recovery for European utilities, but remain cautiously optimistic due to declining earnings growth in 2025. Trading at its fair value for the five-year forward P/E average of 14.6x, we do not see a huge beat compared to other sectors.

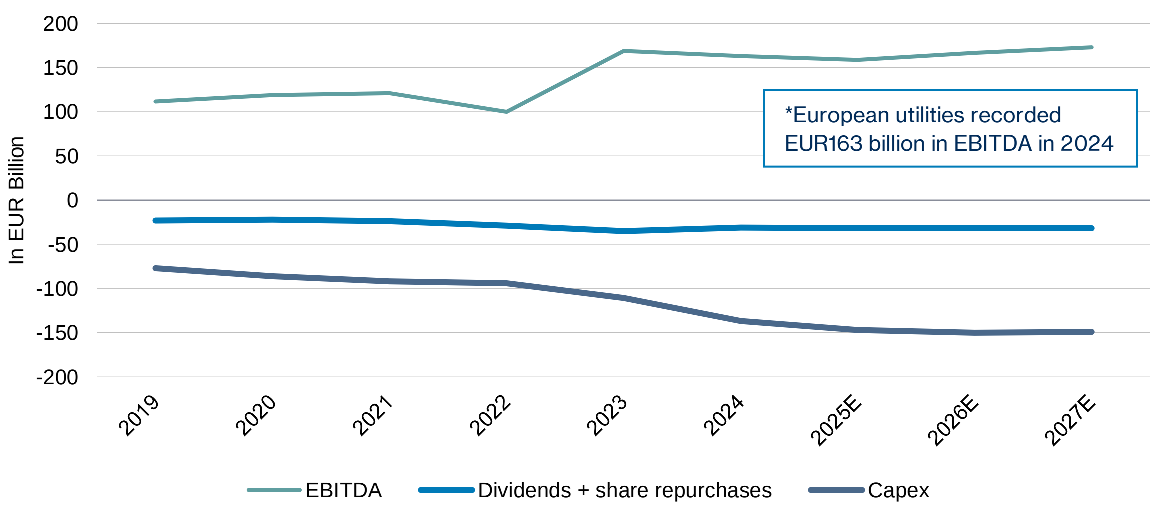
Figure 1: S&P Europe 350 Utilities Index vs. S&P Europe 350 Index



Source: S&P Global Market Intelligence.

We expect more turbulence for European utilities during President Trump's second term. We believe the Trump administration's policy shifts in 2025 could impact European utilities, leading to a more volatile European utilities market in 2025. The Trump administration has signaled a potential tariff of up to 25% on European goods due to the EU's trade surplus with the U.S., which could potentially lead to supply chain disruptions for essential components such as transformers and critical solar and wind farm materials, which could lead to increasing raw materials cost inflation. As European utilities continue to increase renewable investments as committed, an increase in material costs could impair their financial condition, especially those heavily burdened with debt. Despite potential cost inflation, we expect the top 25 European utility companies by market capitalization to continue expanding their capital expenditure to fulfill investments needed for the energy transition (Figure 2). Despite the growing financial burden from rising investments and shareholder remuneration, European utilities continue to maintain a healthy EBITDA. This strong cash flow is sufficient to support ongoing renewable investments and shareholder payouts without significantly increasing leverage. We remain positive about our top picks, such as Iberdrola and Enel, which maintain substantial renewable investment and healthy cash flows.

Figure 2: Increasing Capex for the Top 25 European Utilities, Supported by Healthy EBITDA*



Source: S&P Global Ratings.

President Trump could also be poised for significant changes in his clean energy policy. We think President Trump could aim to bolster the natural gas industry as the U.S.'s important bridge to a cleaner fuel choice, which could lead to increased U.S. export of liquefied natural gas (LNG) and a potential revival of Nord Stream 2. Increasing U.S. LNG exports, especially to Europe, could lead to lower natural gas prices in the region and potentially challenge renewables' competitiveness in the short term. Hence, it could disrupt global energy markets, especially affecting those European utilities with fewer hedging mechanisms. Despite a potential slowdown in investment in the U.S.'s clean energy technologies, we think this would not bring a similar negative effect on European utilities with heavy renewable exposure. In contrast, we think it could reinforce Europe's commitment to energy independence and renewables by accelerating domestic investments in renewable energy.

While we expect interest rates to trend lower in 2025, we believe they will remain at elevated levels compared to historical levels. Therefore, we see valuation recovery for European utilities in 2025, but do not expect a huge beat compared to other sectors. We continue to believe the European Central Bank (ECB) could lead among major central banks in rate cuts. As bond yields decline, yield-focused sectors like utilities become more attractive relative to fixed-income assets, owing to their higher shareholders' remuneration, hence leading to a potential recovery in European utilities. Still, we are cautiously optimistic about potential valuation recovery, as the Trump administration policies, such as tariffs and fiscal expansion, could drive higher U.S. and global inflation. Also, this could lead to a delay in ECB rate cuts, which would keep relatively high borrowing costs for renewables and grid expansion and thus disrupt the recovery in valuation for European utilities. Given that the S&P Europe 350 Utilities Index is trading at its fair value, we also think it is unlikely to experience a massive outperformance versus growth.

European electric utilities with a balanced mix of renewables and grids, along with a heavy proportion of regulated businesses, remain attractive in 2025 despite the utilities sector's underperformance in 2024. Despite potential clean energy policy changes by the Trump administration, we still see strong renewable energy investment in Europe, owing to EU Green Deal policies and decarbonization goals. We think this could benefit utility companies with huge renewable exposure. Given the stable and predictable cash flows from grids, a balanced mix of renewables and grids is preferable, as it could provide potential earnings growth from renewables and consistent downside potential from grids against commodity price volatility. Meanwhile, a heavy proportion of regulated businesses is beneficial too, as it provides further resilience against potential turbulence in energy prices. Geopolitical risks arising from changes in U.S. clean energy policies, gas price fluctuations, and demand or supply shocks could cause volatile energy prices, but utilities with strong regulated exposure are less likely to be negatively affected. European utilities with grid operations have inflation-linked regulatory mechanisms, ensuring a reliable revenue stream even in a higher interest rate environment – providing stable shareholders' remuneration. Among our covered European utilities, Iberdrola and Enel continue to stand out due to their strong renewable investments and robust grid infrastructure.

To wrap up, President Trump's upcoming policies could introduce challenges for European utilities, but with the expectation of lower interest rates, we are still confident in the valuation recovery for European utilities. We see altering trade dynamics in energy markets that could affect energy prices and potential supply chain disruptions from EU tariffs could negatively affect European utilities. However, we anticipate lower interest rates could lead to the recovery of European utilities' valuation, but we do not see a huge beat compared to other sectors. That said, we are still highly selective of our picks for European utility companies, focusing on those with high renewable exposure for better earnings growth and adequate grid exposure for better resiliency against a volatile energy market. Our top picks in 2025 for European utilities are Iberdrola and Enel, both of which offer dividend yields and a gearing ratio that are better than the industry average (Table 1). Also, both Iberdrola and Enel are trading at a similar valuation to the industry average, which we see further upside due to an improved profit outlook and shareholders' remuneration.

Table 1: Iberdrola and Enel's Above-Average Fundamentals vs. Industry Average

Company	2024 Dividend Yield (%)	P/E	EV/EBITDA	Gearing Ratio
Iberdrola, S.A.	5.7%	16.1	9.5	0.89
Enel SpA	7.5%	11.4	7.2	1.67
Industry Average	**5.3%**	**16.4**	**9.3**	**1.71**

Source: CFRA, S&P Global Market Intelligence. Data as of March 5, 2025.

Risk Factors

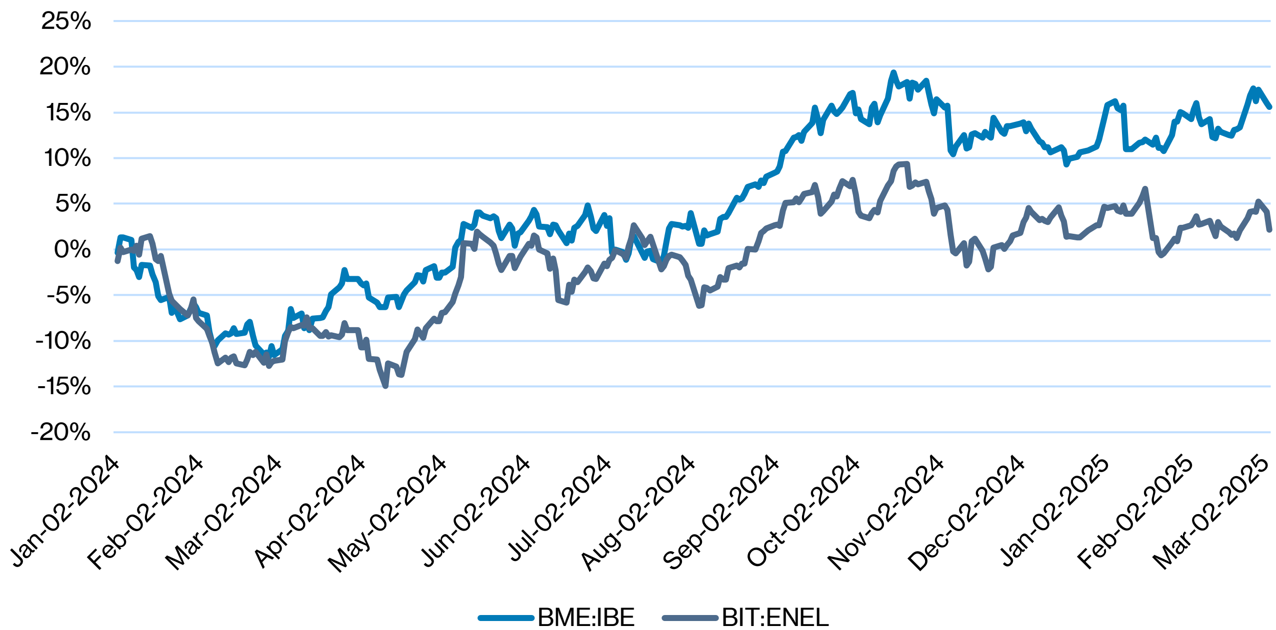
The key risks to our analysis include stricter-than-expected policies from President Trump and slower-than-expected rate cuts. While we still expect a slow recovery in European utilities, the introduction of strong pro-energy independence policies that favor fossil fuels over renewables could potentially heavily impact global energy markets and, consequently, the energy market prices. Also, a stronger-than-expected tariff could increase cost inflation and, therefore, financial risks for European utilities. We assume interest rates to trend lower in 2025, but slower-than-expected rate cuts by the ECB, which could be triggered by stagnant inflation, could lead to a slower recovery in European utilities, leading to prolonged underperformance against the broader market.

Company Implications

Enel SpA (ENEL IM EUR7 ****) is an Italian utility company involved in the production, distribution, and sale of electricity and gas in Europe, North and Latin America, and internationally. With a strict focus on its strategic pillars, we expect Enel to maintain its profitability and financial discipline through better cash generation and asset disposal, which should also underpin a sustainable dividend despite slower regulated asset base (RAB) growth due to disposals. Enel's 2024-2026 strategy could boost free cash flow with sustained capital discipline owing to its planned disposal plan, which could help it achieve its earnings targets for net income compound annual growth rate (CAGR) of 9% to 10% from 2022 to 2025, in our view. Also, given that 80% of its forecasted EBITDA through 2025 will come from regulated or contracted businesses, the company's limited exposure to merchant risk bodes well for its earnings stability, making it one of the most resilient companies against market uncertainties, such as President Trump's policies, which could disrupt energy market prices. In terms of valuation, Enel is trading at a premium to its historical average in terms of the EV/EBITDA multiple, but we still anticipate an upside in its valuation, justified in our view by its attractive growth potential driven by renewable capacity addition.

Iberdrola S.A. (IBE SM EUR14 ****) is the largest Spanish electric utility with major revenue contribution from electricity production through renewable sources, including wind, solar, hydro, and biomass (63% of 2024's total revenue) and networks (37%). We are positive about IBE's attractive earnings growth prospects, with three-year forward earnings growth of 6.5% and good earnings visibility from its EUR41 billion investments in networks and renewable energy by 2026, mostly in A-rated countries like the U.S. and U.K. Also, we continue to see improved margin, owing to better economies of scale from additional renewable capacity and better rates in Brazil, the U.S., and the U.K. In terms of leverage, IBE's balance sheet remains healthy with an adjusted net debt/EBITDA of 3.4x as of Q4 2024 versus the peer average of 4.1x. Hence, the long-term outlook is favorable, in our view, due to the company's two-pronged push into networks and renewables, well positioning with the ongoing energy transition in Europe, such as Electricity Market Reform and the Net Zero Industry Act. Its balanced portfolio mix will provide resiliency against market uncertainties, such as potential President Trump's policies that could disrupt energy market prices. Trading at its forward five-year EV/EBITDA average of 14.7x, we still foresee potential upside in its valuation, justified in our view due to its improved profit outlook and shareholders' remuneration.

Relative Performance



Source: CFRA, S&P Global Market Intelligence.

Implications*

Positive implications: CFRA sees an improvement in company fundamentals, which could include (but are not limited to) improved pricing, strengthening backlog, market share gains, cost improvements, a more favorable regulatory environment, or improving demographic trends, over the next 12 months.

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