9th February 2016

Utilities

Engie

Price EUR13.91

It's getting closer!

Fair Value EUR19 (+37%) **BUY**

Bloomberg	GSZ FP
Reuters	GSZ.PA
12-month High / Low (EUR)	19.9 / 13.8
Market Cap (EURm)	33,863
Ev (BG Estimates) (EURm)	76,568
Avg. 6m daily volume (000)	6 160
3y EPS CAGR	0.5%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-7.6%	-14.1%	-22.4%	-14.8%
Utilities	-4.2%	-10.4%	-14.0%	-7.9%
DJ Stoxx 600	-7.9%	-17.3%	-20.8%	-14.1%

YEnd Dec. (EURm)	2014	2015e	2016e	2017e
Sales	74,686	80,241	80,118	80,047
% change		*7.4%*	*-0.2%*	*-0.1%*
EBITDA	12,358	11,515	11,810	11,918
EBIT	6,574	6,540	6,696	6,647
% change		*-0.5%*	*2.4%*	*-0.7%*
Net income	3,125	2,737	2,849	2,981
% change		*-12.4%*	*4.1%*	*4.6%*

	2014	2015e	2016e	2017e
Operating margin	8.8	8.2	8.4	8.3
Net margin	4.2	3.4	3.6	3.7
ROE	5.6	5.0	5.2	5.4
ROCE	4.5	4.2	4.2	4.1
Gearing	53.2	56.6	59.3	61.5

(EUR)	2014	2015e	2016e	2017e
EPS	1.11	1.02	1.09	1.13
% change	*-*	*-7.8%*	*6.3%*	*3.6%*
P/E	12.5x	13.6x	12.8x	12.3x
FCF yield (%)	9.0%	4.6%	3.8%	4.4%
Dividends (EUR)	1.00	1.00	1.00	1.00
Div yield (%)	7.2%	7.2%	7.2%	7.2%
EV/Sales	1.1x	1.0x	1.0x	1.0x
EV/EBITDA	6.6x	6.6x	6.5x	6.5x
EV/EBIT	12.5x	11.7x	11.5x	11.7x

Yesterday "La Lettre de l'Expansion" indicated that Engie's new cost-cutting programme could target EUR2.8bn in gains over 2016-18, without mentioning any details on the type of reduction (opex/capex/other costs), the gross/net ratio, or the scope over which the programme is to be implemented. These rumors, combined with the disposals programmme, confirm that the group's reorganisation is well on track, making us comfortable with our Buy rating. We hope to have more details at the group's earnings presentation (25th February). Positive.

ANALYSIS

- **An ambitious new Perform plan…** Yesterday morning, **Reuters & Bloomberg** indicated (quoting "**La Lettre de l'Expansion**") that Engie could announce a new cost-cutting programmme of **EUR2.8bn** for 2016-18 during its 2015 earnings presentation (25th February). This could imply annual cost reductions of around **EUR900m** (7.8% EBITDA reduction, per year). In all, assuming the group is able to keep **100%**, this would imply a positive impact of **>24%** on the 2015e EBITDA level (>12% assuming the group keeps 50%) and 21% on our current 2018e EBITDA estimate. This further **EUR2.8bn** costs reduction programme is clearly higher than our forecasts and those of the market. In comparison, the last programmes were **1/ the 2012-15 Perform Plan** which aimed at reducing the group's cost base by **EUR1.9bn**, net of inflation costs (EUR475m/year) with a progressive ramp-up (>75% in year's two and three) and **2/the Quick reaction programme***,* which aimed at further reducing the group's cost base by **EUR500m** over 2015 and 2016 (EUR250m/year). This new programme implies a doubling in the previous annual efforts the group was able to generate, leaving us skeptical about the group's ability to achieve it @ 100%. In addition, given the lack of financial details, we have no clue on the split between opex and capex savings, that could positively change the EBITDA margin. As a reminder, in our model we previously only assumed less than **EUR100m** in annual net contribution at the EBITDA level over the period, implying potential positive adjustments in our estimates once all the details of this plan are unveiled. Assuming the group keeps half of the **EUR2.8bn** programme at its EBITDA level and assuming a similar retention rate for the group's NRI than the previous Perform plan, implies a net positive impact of **>20%** on our 2018 adjusted EPS and a positive impact of **EUR1-1.5/share** on our current **EUR19/share FV**.
- **…Combined with the massive asset disposal programme…**"La Lettre de l'Expansion" also stated that the group plans to sell **EUR15-20bn** worth of assets over 2016-18, including **EUR7bn** in the short term. The group's E&P business, coal fired power plants, US plants and some infrastructure assets seem to be the targeted assets. The asset sales list also includes various other non-strategic assets, worth **EUR3-5bn**, as well as the opening of Electrabel's capital. Disposals are not new, yet given recent press rumours we assume a deal in US thermal assets is closed to being finalised (**EUR4-5bn EV**), as well as a deal in coal-fired power plants in Asia (**EUR2-3bn EV**). At the right prices, these deals could fit perfectly with the group's mid to long-term strategy to reduce its direct exposure to merchant activities, to the benefit of regulated activities.
- **…to the benefit of a new Engie**: The group's reorganisation is currently ongoing, despite the two year extension for Mr Mestrallet at the head of Engie board. Most fears over the investment case concern a potential dividend cut, assuming the new structure (post disposals, and post cost-cutting programme) is unable to correctly finance the **EUR1/share** dividend (with a 65-75% payout). Yet at the current share price we assume this risk is more than priced-in since the market is currently pricing in a cut from EUR1/share to EUR0.8/share, which we judge as quite excessive.
- **Conclusion:** We are sticking to our Buy rating with a FV unchanged at **EUR19/share.**

VALUATION

- At the current share price the stock is trading at 6.5x its 2016e EBITDA and offers a 7.2% yield
- Buy, FV @ EUR19

NEXT CATALYSTS

- 25th February 2016: 2015 earnings

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