14th March 2016

Utilities

Suez

Price EUR15.77

A free option?

Fair Value EUR19 (+20%) **BUY-Top Picks**

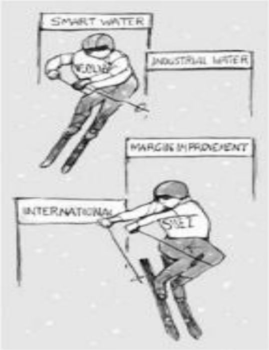
Bloomberg	SEV FP
Reuters	SEVI.PA
12-month High / Low (EUR)	19.0 / 15.1
Market Cap (EUR)	8,557
Ev (BG Estimates) (EUR)	20,619
Avg. 6m daily volume (000)	1 339
3y EPS CAGR	3.2%

	1 M	3 M	6 M	31/12/15
Absolute perf.	1.9%	-9.0%	-4.1%	-8.6%
Utilities	7.9%	-3.2%	-0.4%	-5.3%
DJ Stoxx 600	12.7%	-3.8%	-3.8%	-6.4%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	15,135	15,413	15,970	16,365
% change		*1.8%*	*3.6%*	*2.5%*
EBITDA	2,751	2,704	2,917	3,097
EBIT	1,381	1,300	1,458	1,568
% change		*-5.9%*	*12.2%*	*7.5%*
Net income	559.8	424.2	543.1	614.8
% change		*-24.2%*	*28.0%*	*13.2%*

	2015	2016e	2017e	2018e
Operating margin	9.1	8.4	9.1	9.6
Net margin	3.7	2.8	3.4	3.8
ROE	8.2	6.3	8.1	9.0
ROCE	8.0	7.2	7.9	8.5
Gearing	121.6	134.1	139.2	138.1

(EUR)	2015	2016e	2017e	2018e
EPS	1.04	0.79	1.01	1.14
% change	-	*-24.2%*	*28.0%*	*13.2%*
P/E	15.2x	20.0x	15.6x	13.8x
FCF yield (%)	3.0%	0.4%	2.7%	6.9%
Dividends (EUR)	0.65	0.65	0.68	0.77
Div yield (%)	4.1%	4.1%	4.3%	4.9%
EV/Sales	1.3x	1.3x	1.3x	1.3x
EV/EBITDA	7.3x	7.6x	7.2x	6.9x
EV/EBIT	14.6x	15.9x	14.5x	13.6x



During a roadshow with Suez, the main 2016 short-term guidance was reiterated, as well as more strategic 2017 "ambition" targets. Like Veolia, and other European environmental service groups, Suez is suffering from the lack of growth in its traditional business and thus has no choice but to optimize its costs structure, look for growth internationally and strive for external growth. All three options are well addressed by Suez's management, with one common objective: not altering the group's equilibrium (financially, and in terms of business). At the current share price, we assume M&A opportunities, although well identified, are not fully priced in by investors. We remain buyer.

ANALYSIS

- **2016 guidance reiterated:** During this roadshow, Suez reiterated its 2016 targets: **1/**LFL sales growth (*at average climate*) of **2%** minimum, **2/**LFL EBIT growth (*at average climate too and restated for 2015 capital gain*) above **2%; 3/**FCF generation around **EUR1bn** as in 2015; **4/** a net debt/EBITDA ratio around **3x** and **5/**a minimum dividend of **EUR0.65/share**. Outlook for 2016 remains poor, especially in Europe where inflation is low, and industrial recovery very limited. Earnings growth is then set to come from costs cutting program, from new projects at international, and from growth coming from regulated activities (*higher inflation in US and Chile*).
- **…as well as 2017 "ambition" targets**: 2017 ambition to generate **EUR3bn** of EBITDA by 2017 was reiterated, o/w 50% of this EBITDA growth (*compared with 2015*) is linked to M&A deals. The group's objective is not to find a deal "at any price", implying if it has difficulties the find the perfect match it will not reach its 2017 target, for good reason. Yet given the research scope of the group *(international, regulated business, Europe…),* we assume a deal could be realized (*in our model we assume EUR500m of M&A spending over 2016-17, with the first EBITDA contribution in 2017).*
- **Not altering the group's equilibrium is key**: Management's mid-to-long term target is to maintain the group's equilibrium which allows Suez to get through all different economic & industrial cycles, implying the potential M&A deals they are currently looking at do not aim at totally modify the group's current structure. As a reminder, Suez is generating **51%** of its sales within Water business, and the remaining **49%** within Waste, with geographical sales being almost equally split (*34% in France, 35% RoEurope and 31% RoWorld*). Regulated water businesses (*Aguas Andinas & United Water)* still represent around **20%** of the group's EBITDA, with the group ready to potentially increase this share assuming opportunities (*in US notably*) appear. Contrary to Veolia, which aims at specializing in some nice markets, Suez strategy implies more equilibrium between businesses, to the profit of margin stability over the cycles.
- **A free option?** Current multiples *(2016e restated EV/EBIT at16x; 2016 P/E at 19.9x)* as well as current 2017 consensus (*EBITDA at around EUR2.9bn*) clearly implies M&A opportunities the group is currently looking at are not well priced in by investors, despite being well identified. Assuming only some of the analysts covering the stock (*including us*) include M&A in their models could imply up to **4-6%** positive adjustment on 2017 EBITDA, assuming a deal is being announced, before year's end.
- **Conclusion**: We updated our model with 2015 numbers and cut our 2016-17 EPS by less than **2.5%** on average, without modifying 2018. We stick to our Buy rating with FV unchanged at **EUR19**. We still expect higher positive consensus adjustment potential from Suez than from Veolia.

VALUATION

- At the current share price, Suez is trading at 20x its 2016 P/E and offers a 4.1% yield
- Buy, FV @ EUR19

NEXT CATALYSTS

- April 28th 2016: Q1-16

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