4th May 2016

Utilities

Veolia Environnement

Price EUR20.89

Q1 first take: Poor sales performance and solid LfL EBITDA growth as expected

Fair Value EUR22 (+5%) **NEUTRAL**

Bloomberg	VIE FP
Reuters	VIE.PA
12-month High / Low (EUR)	22.9 / 17.8
Market Cap (EURm)	11,766
Ev (BG Estimates) (EURm)	19,210
Avg. 6m daily volume (000)	1 946
3y EPS CAGR	28.1%

	1 M	3 M	6 M	31/12/15
Absolute perf.	0.8%	-5.4%	-1.6%	-4.5%
Utilities	2.9%	0.4%	-7.1%	-3.8%
DJ Stoxx 600	0.7%	1.9%	-11.3%	-8.3%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	24,965	25,324	25,870	26,474
% change		*1.4%*	*2.2%*	*2.3%*
EBITDA	2,997	3,148	3,310	3,471
EBIT	1,060	1,375	1,520	1,630
% change		*29.8%*	*10.5%*	*7.2%*
Net income	380.2	517.0	708.2	798.9
% change		*36.0%*	*37.0%*	*12.8%*

	2015	2016e	2017e	2018e
Operating margin	4.5	5.4	5.9	6.2
Net margin	1.8	2.3	3.0	3.3
ROE	4.0	5.2	7.0	7.8
ROCE	6.4	7.9	8.3	8.7
Gearing	82.6	80.8	77.8	74.9

(EUR)	2015	2016e	2017e	2018e
EPS	0.68	0.92	1.26	1.42
% change	-	*36.0%*	*37.0%*	*12.8%*
P/E	30.9x	22.7x	16.6x	14.7x
FCF yield (%)	9.0%	0.5%	6.3%	7.2%
Dividends (EUR)	0.73	0.72	0.90	0.96
Div yield (%)	3.5%	3.4%	4.3%	4.6%
EV/Sales	0.7x	0.8x	0.7x	0.7x
EV/EBITDA	5.9x	6.1x	5.8x	5.5x
EV/EBIT	16.6x	14.0x	12.6x	11.7x

Veolia posted a poor Q1 sales performance and solid LfL EBITDA growth as expected. As for Suez, earnings growth was only generated by the cost reduction programme, and not by a rebound in activities. We were positively surprised by stable activities in France while Suez posted a LfL decline in the region last week but were not surprised by the good contribution from cost cutting. Despite this, we are sticking to our Neutral recommendation as we think only positive macro surprises from Europe or North America could drive up consensus. FV unchanged at EUR22/share.

ANALYSIS

- **Main Q1 metrics:** As expected, Veolia posted a poor Q1 sales performance, with total sales down **3.4%** YoY to **EUR6.09bn** below our forecast for a **1.8% YoY** sales decline. Most of the drop stemmed from a slowdown in construction and more importantly, from adrop in energy prices. On a LfL basis sales were down **1.7%.** This should be compared with **+1.5%** for Suez. French activities were relatively flat, which is positive in our view, in both the water and waste segments while sales outside France (Europe and RoW) were affected by the decline in landfill volumes in the UK and by lower energy prices, mild weather and challenging industrial services in the US. The group was able **generate positive** LfL sales growth in waste (+1.2%) while Suez posted one week ago a **-1.8% LfL sales** performance (European waste segment only). Volumes treated were positive at **+1.6%.** As for EBITDA, Veolia was able to post **EUR840m** in line with our expectation (EUR843m), reflecting as expected **3%** YoY growth and **5%** LfL growth (Suez posted respectively -3.9% and -1.6%). Costs reduction program was the main earnings growth driver. Current EBIT came out at **EUR413m** (BG at EUR410m) reflecting a 4.2% YoY rise and a +7.5% LfL surge. Current net income came out slightly below our forecast at **EUR173m** (**BG at EUR190m**) with a lower contribution from capital gains compared with last year. Net debt remained almost stable at around **EUR8.26bn.** All 2016 targets were reiterated.
- **What to retain from this publication? 1/**Q1 sales performance was poor, as anticipated, as the group suffered from an unfavourable weather effect in the US (higher temperatures, lower energy prices) and from a fall in commodity prices. Despite this drop we are positively surprised by the good performance of the group in France on its two segments while Suez posted more negative metrics. Waste segment in France at Veolia declined only by **1%** LfL vs. **-5.4%** posted by Suez in Q1-16 while on water segment, Veolia posted stable revenue vs. **-1%** posted by Suez. We expect more details during conference call. **2/**EBITDA performance was in line with expectations and clearly confirms group's restructuring program is the main growth driver (*Veolia EBITDA would have decline by 3.3% YoY assuming no costs reduction)* as for Suez (*Suez EBITDA would have fall by 10%). **3/***2016 targets to generate sales and EBITDA LfL growth, to generate EUR650m of FCF and to posted current net income of at least EUR600m were confirmed.
- **Conclusion:** Earnings growth generated by Veolia was more impressive than earnings growth generated by Suez during Q1 and the 2016-18 consensus seems less at risk for Veolia given that it is not based on M&A. Yet when looking at valuation and implicit yield we see Veolia is today offering a less attractive yield than Suez even after integrating a dividend rise.The implicit risk reward on Suez appears to us more attractive than at Veolia. **Neutral rating confirmed with FV unchanged at EUR22.**

VALUATION

- At the current share price the stock is trading at 6.1x its 2016e EBITDA and offers a 3.4% yield
- Neutral with FV @ EUR22

NEXT CATALYSTS

- Conference call at 08.30am

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