

Sector View

Construction & Materials

TOP PICKS Q3 16: A combination of decent visibility (VINCI) and a bit of cyclicity (Imerys)

	1 M	3 M	6 M	31/12/15
Cons & Mat	-7.4%	-4.9%	-5.9%	-5.9%
DJ Stoxx 600	-5.1%	-2.3%	-9.8%	-9.8%

*Stoxx Sector Indices

Companies covered

Company	BUY	EUR30
CRH	BUY	EUR30
Last Price	EUR26	Market Cap. EUR21,571m
EIFFAGE	BUY	EUR73
Last Price	EUR64.21	Market Cap. EUR6,298m
HEIDELBERGCEMENT	BUY	EUR86
Last Price	EUR67.47	Market Cap. EUR12,679m
IMERYS	BUY	EUR72
Last Price	EUR57.53	Market Cap. EUR4,578m
LAFARGEHOLCIM	BUY	CHF50
Last Price	CHF40.54	Market Cap. CHF24,604m
SAINT GOBAIN	BUY	EUR46
Last Price	EUR34.355	Market Cap. EUR19,062m
VICAT	NEUTRAL	EUR56
Last Price	EUR50.9	Market Cap. EUR2,285m
VINCI	BUY	EUR72
Last Price	EUR63.69	Market Cap. EUR37,873m

LOOKING BACK ON Q2 2016

Q2 has been a disappointing quarter for stocks in the construction and building materials sector. Apart from CRH (up 3.7%), no genuinely positive performance was noted. Cyclical players have been under pressure since roughly the second half of April and of course Brexit has taken its toll more recently. In addition, investors have taken profits on Eiffage and VINCI, after a very good performance in 2015 and in Q1 2016 - despite an impressive start to the year on the toll roads traffic side (6.5% APRR, 7.2% VINCI Autoroutes).

WHAT WE SEE FOR Q3 2016

The first quarter is usually not the most relevant one for construction and building materials financial performance, as it is usually polluted by calendar and weather effects. It is a modest quarter too, especially for cement players. Second quarter publications, expected in late July/early August for most companies in the sector, should be much more representative of underlying business trends. We expect a satisfactory performance here: further improvements in key cement markets, in particular the US and India, while prices might gradually improve.

Nevertheless, due to the Brexit vote, we expect investors to be much more sensitive to risk and cyclicity, especially for companies exposed to Europe. Therefore, we would be cautious during the third quarter on Saint-Gobain (67% of 2015 sales exposed to Western Europe - 12% to the UK), Vicat (c50% of 2015 sales), CRH (c36% of EBITDA), HeidelbergCement (around 30% of sales exp. to Western & Northern Europe). On the currencies side however, the riskiest stock is probably LafargeHolcim, which reports in CHF while most revenues are generated outside of Switzerland, while CRH should benefit from its US exposure (c38% of EBITDA)

CONCLUSIONS AND TOP PICKS

Following the Brexit vote, we have withdrawn HeidelbergCement from the Top Pick list, due to its cyclical profile. In a more cautious approach, we have chosen VINCI and Imerys as Top Picks for the Q3 period:

- Alongside Eiffage, VINCI is the least cyclical stock in our coverage. 63% of 2015 EBITDA was generated by toll roads and 8% by airports. We see no obvious risks on toll roads traffic, on the contrary. Light vehicles traffic might continue to benefit from macro uncertainties (cheaper local holidays favoured) and geopolitical risks (public transport avoided) and heavy vehicle traffic from slightly positive industrial production (+1.3% in April, +0.6% on 12 months). We foresee 2% y/y traffic growth in Q2, while players could actually report stronger figures. On the contracting side, the group is mostly exposed to non-residential (c25% est. of total sales) and civil works (c55% est.) and to France (c60% of sales). We are presumably close to the trough in France for Construction and we see no risk of negative newsflow during the Summer: The Grand Paris is not likely to be disturbed by Brexit and VINCI order intakes were up 12% in Q1. Finally, 7% of VINCI sales are generated in the UK but we doubt strong earnings will be reported this year, due to VINCI Construction UK woes on a tramway project (losses last year, close to breakeven this year). VINCI reports H1 figures on 28th July post market and we expect a 1.2% decline for sales at EUR17.7bn and Operating income (from ordinary activities) at EUR1.63bn (9.2% margin, up 60bps, partly due to a mix effect).
- We have added Imerys to the Top Pick list for the third quarter in order to shake it up somewhat. Imerys is cyclical yet much more resilient than Saint-Gobain for instance, or a cement player. We have therefore introduced some cyclicity but not too much (Imerys' Beta stands at 0.9): it is very well diversified (in term of markets and countries), has numerous leadership positions and operating margins are more than decent at 13%. Timing looks fine: Q1 2016 was good, with a lower volume decline (-2.6% vs -5.9% in 2015) and margin improvement (+30bps on reported current EBIT) while the comparison basis will remain easier. Proppant sales of EUR22m were mostly generated in Q1 and this division mostly reported losses as of Q2 2015. H1 figures will be reported on 27th July and we expect sales at EUR1.1bn for Q2 2016 (-1.5% lfl) and current operating income at EUR158m (14.3% margin).

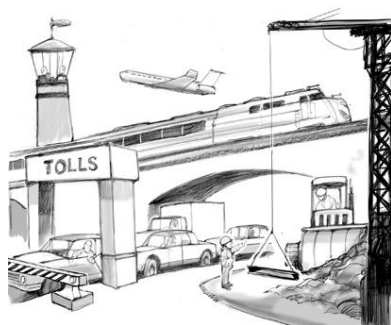
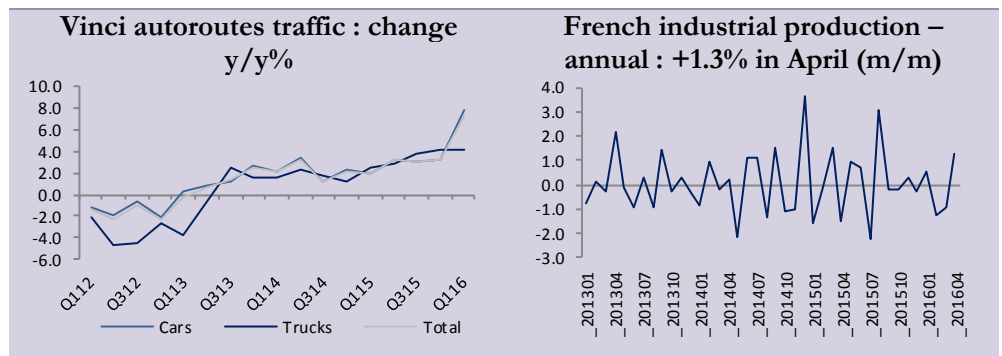
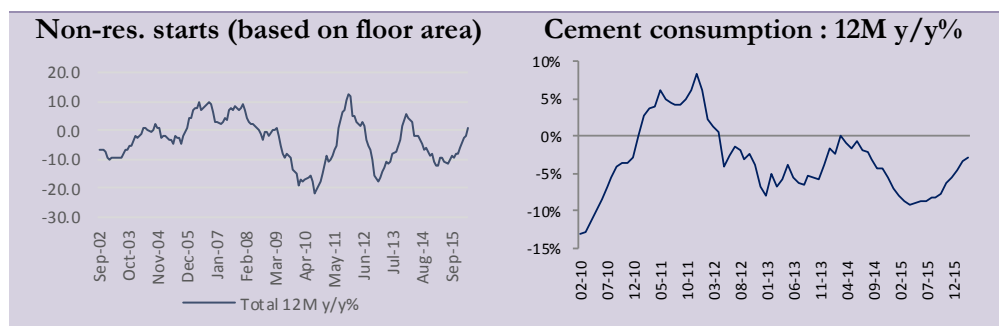


Fig. 1: Vinci: Traffic performance and industrial production



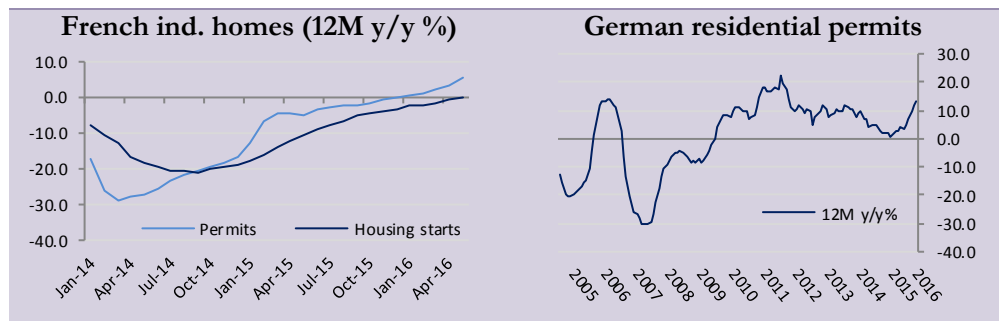
Sources: Vinci, Insee, Bryan, Garnier & co

Fig. 2: Vinci: French non-residential statistics and French cement volumes



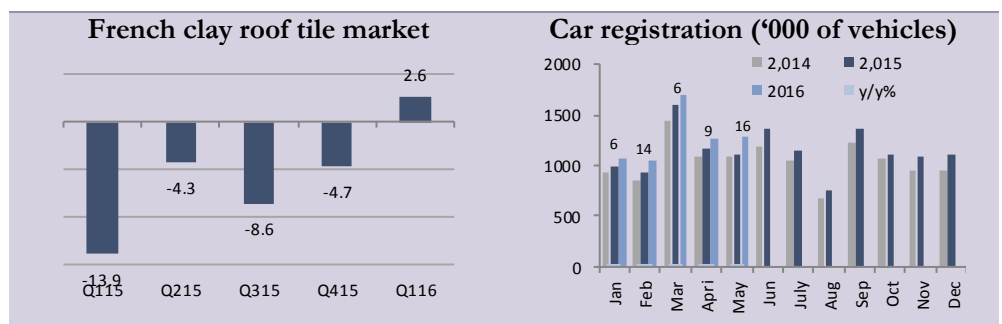
Sources: French government, SFIC, Bryan, Garnier & co

Fig. 3: Imerys: French individual homes market, German permits



Sources: French government, Destatis.com, Bryan, Garnier & co

Fig. 4: Imerys: French clay roof tile market – European autos



Sources: Unicem, ACEA, Bryan, Garnier & co

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Analyst :
 Eric Lemarié
 33(0) 1.70.36.57.17
 elemarie@bryangarnier.com

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London	Paris	New York	Munich	New Delhi
Beaufort House	26 Avenue des Champs Elysées	750 Lexington Avenue	Widenmayerstrasse 29	The Imperial Hotel Janpath
15 St. Botolph Street	75008 Paris	New York, NY 10022	80538 Munich	New Delhi 110 001
London EC3A 7BB	Tel: +33 (0) 1 56 68 75 00	Tel: +1 (0) 212 337 7000	Germany	Tel +91 11 4132 6062
Tel: +44 (0) 207 332 2500	Fax: +33 (0) 1 56 68 75 01	Fax: +1 (0) 212 337 7002	+49 89 2422 62 11	+91 98 1111 5119
Fax: +44 (0) 207 332 2559	Regulated by the	FINRA and SIPC member		Fax +91 11 2621 9062
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Financial Conduct Authority (FCA)	Autorité de Contrôle prudentiel et de			rue de Grenus 7
	resolution (ACPR)			CP 2113
				Genève 1, CH 1211
				Tel +4122 731 3263
				Fax+4122731 3243
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