

25th July 2016

Utilities

Suez

Price EUR14.12

Preview H1 2016: key updates awaited on cost-savings and M&A

Fair Value EUR17.5 (+24%)

BUY

Bloomberg	SEV.FP
Reuters	SEVI.PA
12-month High / Low (EUR)	18.3 / 12.9
Market Cap (EUR)	7,684
Ev (BG Estimates) (EUR)	18,769
Avg. 6m daily volume (000)	1,268
3y EPS CAGR	-2.0%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-1.3%	-12.1%	-15.4%	-18.2%
Utilities	2.3%	2.8%	3.8%	-0.9%
DJ Stoxx 600	-0.3%	-2.3%	0.6%	-7.0%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	15,135	15,456	16,066	16,557
% change		2.1%	3.9%	3.1%
EBITDA	2,751	2,653	2,791	2,932
EBIT	1,381	1,287	1,355	1,459
% change		-6.8%	5.3%	7.7%
Net income	559.8	402.8	463.9	527.1
% change		-28.1%	15.2%	13.6%

	2015	2016e	2017e	2018e
Operating margin	9.1	8.3	8.4	8.8
Net margin	3.7	2.6	2.9	3.2
ROE	8.2	5.9	6.8	7.7
ROCE	8.0	7.3	7.5	8.0
Gearing	121.6	124.2	129.0	132.0

(EUR)	2015	2016e	2017e	2018e
EPS	1.04	0.75	0.86	0.98
% change		-28.0%	15.2%	13.6%
P/E	13.6x	18.9x	16.4x	14.4x
FCF yield (%)	3.4%	5.6%	4.5%	5.2%
Dividends (EUR)	0.65	0.65	0.65	0.66
Div yield (%)	4.6%	4.6%	4.6%	4.7%
EV/Sales	1.2x	1.2x	1.2x	1.2x
EV/EBITDA	6.8x	7.1x	6.9x	6.6x
EV/EBIT	13.6x	14.6x	14.1x	13.3x

Suez is set to report its H1 2016 results on 28th July in the morning. As the macro environment remains challenging for the environmental services company, we do not expect any significant change in Suez's H1 2016 performance. We expect sales to rise slightly in organic terms thanks to a strong performance in the company's international activities, and H1 2016 EBITDA to drop slightly YoY, notably bearing the brunt of a challenging comparable basis and an unfavorable climate which should more than offset cost-savings achieved over the half-year period. We expect the company to give two important updates on its cost-cutting targets (likely to be upgraded, in our view) as well as on its M&A strategy and, a fortiori, on its 2017 EBITDA 'ambition' of EUR3bn, unlikely to be reached as the timing appears too short now for Suez to fully integrate any potential acquisition by 2017. Since we have not included any acquisitions or additional cost-saving measures as yet, we are sticking to our Buy recommendation and maintain our FV at EUR17.5.

ANALYSIS

- What to expect from Suez' H1 2016 publication?** As the global macro environment remains challenging (no significant industrial recovery in Europe, low inflation environment in mature markets), we do not expect any significant inflexion in Suez's Q2 2016 results compared to the company's first quarter performance. We expect H1 2016 revenues to reach EUR7,340m, slightly up 0.6% YoY - despite a 1.3% FX headwind - spurred by a strong performance in Suez's international business division (8.6% organic growth) which should more than offset poor performance in both the Water Europe and Waste Europe segments (+0.3% and -0.8% organically YoY, respectively). On top of a challenging H1 2015 comparable base, we expect Water Europe to bear the brunt of 1) the low inflation environment in Europe; 2) loss of the Lille contract; 3) the unfavorable climate in Chile on top of a flood in one of the company's plants, which should have a negative impact on volumes and the division's EBITDA (low single digit negative impact). As for the waste business, we expect sales to be penalised by the drop in raw materials prices as well as by flattish volumes due to still spluttering industrial production in Europe. We expect the division's H1 2016 EBITDA to drop 0.8% YoY in organic terms, notably due to a EUR19m headwind attributable to the drop in electricity prices (EUR11m in Q1 2016 and EUR8m in Q2 2016). In all, after a 0.1% organic decline in Q1 2016, we expect the company's EBITDA to reach EUR1.263bn in H1 2016 (-0.6% organically YoY) implying a 17.2% EBITDA margin over the half-year period, 50bp below last year's performance. We expect H1 2016 EBIT to reach EUR571m (vs. EUR604m in H1 2015) and net income of EUR147m (vs. EUR141m last year) as we expect a lower minorities impact (EUR95m vs. EUR111m).
- Updates awaited on M&A and cost-reductions:** During the H1 2016 results presentation, we expect Suez to give an update on its M&A strategy as well on its initial EUR3bn EBITDA 'ambition' for FY 2017e. As the timing now looks too short for Suez to fully integrate any potential acquisition, we think the company is unlikely to reach this target, which was to be delivered through both organic growth and M&A (c. EUR200m each). As we believe this is already well priced-in (Suez's share price is down c. 18% YTD - vs. -2.6% for the Stoxx 600 Utilities and -11% for Veolia Environnement - while the consensus currently stands at EUR2,769 vs. EUR2,791m for BG, both well below EUR3bn), we do not expect any significant derating in case of a downgrade to this target. However, we believe any indication below EUR2.800bn would be negatively received by the market as this would imply an organic contribution lower than the c. EUR200m currently anticipated. Despite the still spluttering macro environment, we believe Suez is likely to guide over EUR2.800bn for FY 2017e as we expect the company to announce additional cost-saving measures during its H1 2016 results. Since 2010, Suez has a solid track record in delivering cost-savings. For each of the last five years, the company has upgraded its initial cost-savings target and/or has exceeded it. We believe Suez is likely to upgrade its target this year again. In our recent report ([Haste makes waste, it's upside time!](#)), we estimate that additional EUR90m-EUR100m procurement savings - spread over 2016/2017/2018 - would increase our FV by EURO.3.

VALUATION

- At the current share price, Suez is trading at 7.1x its 2016e EBITDA
- Buy, FV @ 17.5



Table 1: H1 2016 key metrics

Suez - Preview	H1 2016e	H1 2015
Revenues	7,340	7,295
YoY change	0.6%	-
o/w organic	1.9%	-
o/w FX	-1.3%	-
o/w Water	2226	2261
YoY change	-1.5%	-
o/w organic	0.3%	-
o/w Waste	3,120	3,167
YoY change	-1.5%	-
o/w organic	-0.8%	-
o/w International	1,942	1,815
YoY change	7.0%	-
o/w organic	8.6%	-
EBITDA	1,263	1,293
EBITDA margin	17.2%	17.7%
o/w organic	-0.6%	-
o/w FX	-1.7%	-
o/w Water	622	662
o/w Waste	362	368
o/w International	317	303

Source : Company Data; Bryan Garnier & Co. ests.

Table 2: Summarised P&L

P&L -Suez	H1-16e	H1-15
Revenues	7,340	7,295
EBITDA	1,263	1,293
D&A	(557)	(556)
Concessions charges	(132)	(137)
Others	(3)	4
EBIT	571	604
Rebranding costs	(18)	(18)
Restructuring costs	(25)	(28)
Others	(40)	(56)
Income from. Op Activities	489	502
Cost of net debt	(197)	(200)
Taxes	(50)	(50)
Minorities	(95)	(111)
Net income, Group share	147	141

Source : Company Data; Bryan Garnier & Co. ests.

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Analyst :
 Pierre-Antoine Chazal
 33(0) 1.56.68.75.06
 pachazal@bryangarnier.com

Sector Team :
 Xavier Caroen

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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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